ERRATA

Page 9	Line 3	for 'earnings'	read	'increases'
Page 25	Line 4	for 'dividens'	read	'dividends'
Page 34	Line 6	for '71 million square miles'	read	'361,218 square miles'
Page 70	Line 7	for 'pssible'	read	'possible'
Page 71	Title	for 'Notes'	read	'Note'.

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POST-WAR INFLATION IN INDIA – A SURVEY

BY

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FOREWORD

Some months ago the Institute published the reports of the Commodity Prices Board. These were edited by Mr. Sovani and it was first thought that a survey of the economic situation between 1944 and 1948 should be included in the publication. Mr. Sovani wrote the survey for this purpose. However, it became, inevitably, so lengthy that it was decided to publish reports of the C. P. Board without the preliminary survey. This publication comprises, in the main, the survey prepared by Mr. Sovani.* The account as well as the statistics included in the survey bring the story down to the beginning of September 1948. The statistics for only a few later months were available at the time of going to press; also, government had announced a change of policy in September which was expected to be implemented during succeeding months. It was therefore thought best to close the account at the beginning of September 1948. Some observations about the new policy of government, subsequent trends and possible results have been included in this Foreword.

The issue of this survey as an independent publication is an accident. At the same time it has long been the intention of the Institute to initiate a series of biennial or triennial surveys of economic affairs in India. It is hoped that this publication might become the first of such a series. Among various publications of the Institute the only one comparable to this in scope and intent is Publication No. 10. "*War and Indian Economic Policy*". The first edition of this publication was put forth in April 1943. At that time there appeared no realisation on the part of the Government of India of the seriousness of the inflationary situation and of the need for taking strong and comprehensive measures to deal with it. When, a year later, a second edition of the book was issued it was possible to report the emergence of greater understanding and some effective action. The twelve months from April 1943 to April 1944 laid the foundation of the regulatory policy of the Government of India for the rest of the period of war. There had been much improvisation during this period and a great deal yet remained to be done if the policy was to rest on secure foundations and to be built on proper lines. What then appeared to us to be necessary in these directions may be recounted in the terms of the concluding sentences of the second edition of that publication. "The situation during 1943 was for the major part still so

* A note written by me for the Reserve Bank of India at the time of the declaration of the par value of the rupee is also included in the publication. This note may throw useful light on the then facts and expectations and may help in an appreciation of the difficulties of economic judgment and of tendering advice on policy.

difficult that a general anti-inflationary direction to control was all that was perhaps possible or necessary. Today, though there has been some improvement, there is still no room for complacency; and the situation calls for a clearer definition of objectives and a more specific direction to the controls. [In our opinion two immediate steps are necessary. Firstly, every attempt should be made to put a stop to any further expansion of the note issue.] This could be best achieved by the direct imposition of a maximum limit on the issue. Secondly, the various aspects and instruments of economic control should centre round and be co-ordinated by a policy of comprehensive price control. The main objective of this price control should be to stabilise prices at as low a level as circumstances permit. The interests of the poor consumer, rural as well as urban, and of the small producer, agricultural as well as non-agricultural, demand this. It is also indicated as the right policy by consideration of the post-war situation, internal as well as international. The price level of agricultural produce should provide the nucleus for the plan of price control and the main determinant measure of the level of stabilization should be the All-India statutory prices of the main cereals.']

The policy suggested in the above quotation was not followed by the Government of India and no material improvement on the system built up during 1943–44 was made in later war years. It may be said that the suggestion regarding fiscal and currency policy was a counsel of perfection which could not be followed in the circumstances of a desperate war. There was, however, little justification for the inaction of Government regarding coordination and integration of the system of controls and the attempt to bring down the price level. The results of the failure in these directions of the Government of India were experienced in subsequent years.

The rise in prices of agricultural and industrial goods between 1941 and 1943 was large and rapid. The rise, however, was not even in all categories. Thus among cereals, the prices of rice and wheat rose specially rapidly and their level even under control in 1943 was more than three times the pre-war level; on the other hand, controlled prices of millets were only a little higher than double of the pre-war level. Also, there was disparity in movements in controlled prices, especially of rice, which permitted a smaller increase over the pre-war level in some areas than in others. Again, a number of factors combined to keep the prices of some agricultural products, notably cotton and oilseeds, comparatively depressed for the duration of the war. Among manufactured goods, cloth prices had risen most rapidly in 1942–43; their proper control was one of the most vital problems in 1943–44. The increase in the prices of other manufactured commodities was not equally large. Among important consumers' goods the price of sugar remained low at an index of 170 of the pre-war base throughout the war. The price of iron and steel also kept low by comparison. However, prices of the most import-

ant products of general consumption of this industry, galvanized corrugated sheets, reached more than three times their pre-war level before the beginning of 1943 and kept at this high level during subsequent years. The rapid rise of the prices of certain products during 1942–43 increased greatly the profits in some occupations and industries, the cost-price relationship in 1943–44 being highly favourable for the growers of certain products and for some manufacturers.

The relative position of prices and costs was thus far from being properly adjusted when a general system of controls was first brought into being and it was necessary for government to make the necessary adjustments as well as to determine the general level at which prices could be stabilised. If Government had been able to realise the importance of this issue and to deal with it satisfactorily the post-war situation would undoubtedly have proved easier to handle. The weakness of the Indian Government was specially apparent in two directions. It was unable to do anything in relation to the price of wheat which among agricultural products had risen the most. The price of cloth was an even more flagrant case. The prices of cotton had kept low and the profits of the cloth industry had attained extraordinary levels and yet government agreed to leave the control of these prices substantially in the hands of the industrialists themselves and acquiesced in the high margins that they continued to enjoy. The prices of other manufactured products brought under control were also negotiated prices which permitted ample margins to producers and distributors. The policy of the Government of India in this matter was in marked contrast to the policy adopted by other countries which administered a fairly efficient set of controls. In each of these the maintenance of as low a price level as possible was made the supreme aim and when any price was fixed the most meticulous scrutiny of the margin available to the producer or any intermediary was always undertaken. Except for small reductions in the prices of some controlled commodities during 1944–46 Government in India contented itself with maintaining prices at about the levels at which they were first brought under control.

It may be that Government felt that, as a large part of the profits of industry were being drained away through the income-tax, no special pains need be taken to reduce prices. In taking up this attitude government ignored the dynamic effects of the prices of industrial products on the working of the whole economic structure and was, moreover, unduly optimistic as regards its own ability to collect through income taxation the major part of the gains of the industrialists. It is obvious that the price revolution of 1942–44 changed the distribution of income in society in favour of industrialists and the growers of certain agricultural products. The classes to suffer from the change were, as always, the salaried classes, a bulk of wage earners and certain classes of agriculturists In other countries, where controls were early imposed and

successfully administered, the indices of the cost of living were kept substantially below the indices of wholesale prices. That this was done was itself evidence of the ability of these governments to cut close the gains of all types of intermediaries and to soften the incidence of the price rise on the wage earners and the salariat, while permitting primary producers to profit as far as was safe from the situation. Also, in these countries a comparatively favourable treatment was given to the primary producer as compared with the manufacturer; this was shown by the higher increase permitted in the wholesale prices of agricultural commodities than in those of the manufactured goods. The situation in India was different in both these respects. The price level of primary products as a whole did not rise significantly higher than that of manufactured goods, and the cost of living index had risen by 1943, in most centres of Indian industry, at least as much as the general index of wholesale prices, in some it was even higher.

During the period 1943 to 1946 the economic system was subjected to pressures arising naturally out of the situation delineated above. There was pressure on the part of workers for an increase in the wage level which would compensate them in some measure for the increase in the cost of living. The demand of workers for higher wages and allowances met with success, in the different industries, after varying periods. In the important centres of cotton industry, Bombay and Ahmedabad, workers were in receipt of an allowance linked to the cost of living index from almost the beginning of the war. On the other hand, in coal mining and on the plantations the workers received almost no relief for the whole period of the war, during which the real earnings of industrial workers as a whole kept below the pre-war level. The poorer members of the salariat such as inferior government servants, police constables, primary school teachers, the bulk of the employees of the Railway, Posts and Telegraphs Departments, who felt the strain of the increase in the cost of living the most, also began to agitate during the closing years of the war for a much needed relief. The agriculturist in certain tracts developed a sense of grievance during the same period. The increase in the prices of his consumption goods had been more than threefold; on some items of his cost of production, especially livestock and its feed, the increase had perhaps been even more. The prices of his products had, however, kept at a comparatively low level. In the early years the lightening of the money burden of debt and taxation and the low levels of agricultural wages had compensated him somewhat for these disparities in the movements of prices. However, as the agricultural labourer's wage in particular began to mount up and other prices showed no signs of decrease his position appeared in a more and more unfavourable light.

Such was the situation at the end of the war. The general feeling at the time, however, anticipated an immediate slackening of activity and inflationary pressures. These expectations were falsified by actual

events. The causes of this development have been discussed in some detail by Mr. Sovani (pp. 10–13).

In India, the year 1946 was marked by severe political disturbances and the coming into office of a transitional Government. One of the first steps taken by this Government was the raising of the price of sugarcane and lifting of control on the price of jute; and the new Minister of Industries and Supply, Mr. C. Rajgopalachariar, indicated in the Oil seeds Conference in September, 1946, his own bias in favour of general decontrol. The oil seeds group, at this particular time, held a crucial position in the structure of agricultural prices. During the war, prices of two important groups of Indian industrial raw materials (1) cotton and (2) oil seeds had remained comparatively low. The position of Indian cotton had depended, in the pre-war pariod, on demand from other countries, especially Japan. This had vanished since 1940 and had created a problem of surplus production which faced Indian cotton throughout the next five years. The two main oil seeds, viz. ground nut and linseed, had also been dependent to a considerable extent on foreign markets during the pre-war period. These experienced a recession in early war years. Later, the demand for oil seeds revived because of the demand from the belligerent countries. The purchases of these goods during later war years were, however, made in bulk. It was the operations of the U. K. C. C. that controlled mainly the price situation regarding many oil seeds during this time. The situation for the season 1945–46 was substantially different on account of the end of war. Therefore, in this year, Government brought oil seeds under formal control and evolved a basic plan for them for the whole of the country on lines of the basic plan for food-grains. It was at the Conference convened to consider the formation of the basic plan for oil seeds for 1946–47 that the policy of general decontrol was foreshadowed by the Minister of Industries and Supply of the new Government. The plea for decontrol was not immediately accepted; but the basic plan for 1946–47 could not take shape during the season and control over oil seeds was ultimately given up in March 1947.

That 1946 marks a turning point in events and expectations is shown by another significant fact. It has been indicated above that the prices of manufactured goods in India during war-time were negotiated prices. No effort was made by the Government of India to put the pricing of these products on a uniform basis or to exercise the necessary constant downward pressure on them. However, desultory attempts were made by individual departments concerned to scale down prices of individual products and they met with some success upto the year 1946. The readiness of the industrialists to accept a reduction in prices under control is a fair indication of both the facts of business and the prevailing psychology of businessmen. The iron and steel industry

offered a reduction in the prices of its products as late as January, 1947. The attitude of the Tata Iron and Steel Co. in regard to prices may be said to have stiffened only between January 1947 and March 1947. Similar changes for the other industries may be said to have taken place from about one quarter to three quarters of a year earlier. The last reductions accepted by the main industries whose prices were under control were as follows :—for cloth, for the first quarter of 1946; for paper, for the second quarter of 1946; for cement, for the second quarter of 1946; and for iron and steel, for the third quarter of 1946.

In the situation as it had developed by the end of 1946 it was possible for Government to move in one of two directions. It could take steps to rectify the mistakes of the older Government and to integrate and rationalise controls or it could go on gradually or speedily to decontrol. That the former possibility was fully open was illustrated by the appointment of the Commodity Prices Board and the reports presented by that body to Government. In spite of the initial trend, as indicated by action in respect of sugar and jute and by the wavering on the oil seeds question, or perhaps because of the apprehensions raised by these steps in the minds of some of the members of Government, the Commodity Prices Board was set up in February, 1947. It was specifically charged to bring and keep in line the prices of various commodities. The attempt to coordinate controls and regulate prices might have been much more easy and successful if machinery for that purpose had been set up and the lines of policy firmly laid down during the war. However, the position had not worsened beyond repair, in the first quarter of 1947. The reports of the Commodity Prices Board give detailed account of the manner in which it could have been brought under control and gradually improved.

It is now clear that it was political forces rather than economic that made impossible the fruition of the work begun in this direction. The interim Government of 1946–47 was a composite one in which two opposite forces were represented; one in favour of private enterprise and of giving Indian capitalists full opportunities and the other with a bias against Indian capitalists and, therefore, tending towards a programme of socialisation and high taxation of business and industry. The programme of action visualised by the Commodity Prices Board did not necessarily mean adoption of either one or the other extreme. It was a middle of the line programme which, while it refused to allow the capitalist to reap undue profits from the critical economic situation in the country, would not have necessarily meant the extinction of private enterprise or even any large step in the direction of socialisation of industry. As it happened, however, the only support that the work of the Commodity Prices Board, had was from the anti-Indian-capitalist group, with the possible result that the pro-capitalist group felt it necessary to nullify or make impossible the work

of the Board. Thus while the Finance Department would support the policy put forward by the Board, the Industries and the Supply Department could effectively sabotage it.

The reduction to impotence of the Commodity Prices Board synchronized with the appointment of a new instrument of policy-making, the 'Foodgrains Policy Committee.' With the appointment of this Committee it was clear to the well informed that plans for complete decontrol had been well and securely laid. The manner in which the work of this Committee was conducted, its recommendations presented and implemented showed the forces that were now in control and would also control future Indian economic policy. With the partition of the country the one political group that had shown itself capable of withstanding pressure of Indian capitalists had vanished from the scene. Henceforth, it was only a matter of convenience and appropriate opportunity, with what formalities and in what stages the changes were made.

The campaign for decontrol, of which the Foodgrains Policy Committee was the spearhead, gathered momentum with the presentation of the interim recommendations of the Committee (November 1947) and achieved rapid success soon after. The Government of the new state, the Indian Union, seemed to adopt, with the adoption of the policy of decontrol, 'the definite aim of liquidating Government commitments as early as possible' as the first principle of its economic policy. Food controls were the first to go and sugar was decontrolled almost immediately afterwards. Decontrol of cloth and yarn had not to wait for many months and the prevailing sentiment was indicated by the very liberal increases given in the controlled prices of Iron and Steel in January, 1948. Decontrol directly affected the prices of essential consumer goods and through them the indices of the cost of living. Its greatest effects are, therefore, to be observed in the differences, as for November, 1947 and July, 1948, between the indices for prices of cereal foodgrains, cotton manufactures and sugar and for the cost of living in centres like Kanpur.

The failure of the policy of decontrol followed inevitably on the failure of the new policy regarding the supply and prices of foodgrains. The whole thesis of the Foodgrains Policy Committee rested on the supposition that there were enough stocks of grain in the country which decontrol would bring forth and that even a moderate price rise would bring about automatically appropriate adjustments in supply and distribution. It was expected by the Committee that the price rise under decontrol could never be so high as to upset operations of Governments who still undertook certain responsibilities of controlled and rationed distribution. The aftermath showed how weak the foundations of the recommendations of this Committee were. The Bombay Government has been blamed by some of the supporters of the Foodgrains Policy Committee because of its so called rapid decontrol. However, the Foodgrains Policy Committee had itself insisted on individual Provincial

Governments reducing their commitments to a minimum as early as possible. The commitments of the Bombay Government on behalf of the industrial cities were large and were responsible for almost a half of its total commitments under a fully rationed system. Procurement by Government under its compulsory levy scheme was impossible with the large increase of market prices. The quota of imports that the Foodgrains Policy Committee had arbitrarily allowed to the Bombay Government did not suffice for the needs even of the industrial cities. Any substantial increase of prices in the industrial cities was a matter of general concern because in Bombay and Ahmedabad the dearness allowance was linked, especially in case of textile labour, to the cost of living and a sharp increase in the price of food might have immediately affected the price of cloth. The Bombay Government was thus forced to conserve the import quota fixed for it by the Government of India for feeding the population of rationed cities and to decontrol all the other areas in obedience to the behest of the Government of India. The difficulties of the Government of Bombay were the difficulties of deficit provinces. The plight of the surplus provinces illustrates another aspect of the basis of the assumptions of the Foodgrains Policy Committee. For example, the Central Provinces had always been a surplus area and had supplied other provinces with substantial quantities of grain under the basic plan. As might have been expected, and had in fact been pointed out by the writers of the minute of dissent, the surpluses in Central Provinces vanished on decontrol. Not only did the overall surpluses dwindle but also the surplus provinces were not able to contain the urge towards price increase loosened by decontrol. Even with stringent bans on provincial movements, prices in the U. P. and C. P. moved rapidly upwards. The continuance of rationing in some cities protected the cost of living index in those cities. Elsewhere, however, these indices rose rapidly. The disparity is reflected in the different relative movements in the cost of living indices for, say, Bombay and Kanpur.

The Foodgrains Policy Committee also felt that, however urgent the need to feed the people of the country through imports, the financial reasources of the country could not permit of continuance of large imports of foodgrains indefinitely. Therefore, it recommended a maximum target for food imports which should, in no circumstances, be exceeded. The sequel to the adoption of its policy showed, on the one hand, that the Committee had exaggerated the effects of control on the availability of food grains and, on the other, that a rigid limit on imports was unworkable.

During the first half of 1948 price incentive to bring all the supply of foodgrains into the market was abundant; even so the prices, instead of being checked by overabundant supply, continued steadily on the increase. It is not possible to assess the extent of supplies, formerly hidden, which might have now come forward. They were obviously not ample

enough to dampen the market; and throughout the season traders continued to buy up new arrivals in the market at higher and higher prices confident of reaping considerable profit in months after new supply had ceased coming to the market. These expectations of traders were not defeated, and after May, 1948 prices remained on an average at a much higher level than that during the preceding months. Among the provinces which were deemed surplus provinces decontrol had meant a large diminution or an entire extinction of the stock of foodgrains over which Government had control. The only way to act on prices or to relieve in some measure the distress of the classes most affected by rising prices was through controlled distribution of foodgrains in particular areas or to particular classes at specified prices. The only source of obtaining supplies of food grains for the purpose left to Government, after it had thrown over the systems built up through war time, was imports of food grains from abroad. In the face of the serious situation the Government of India did not rigidly adhere to the recommendations of the Foodgrains Policy Committee to impose a maximum limit on the imports of food. Government could not either be callous enough or be careless enough of their own future to maintain the maximum limit on imports at the cost of starvation of large classes of people. Imports had, therefore, to be brought in, in much larger quantities than had been necessary in any previous year and the situation was partially stabilised through their aid.

It is no matter of surprise that imports were large after decontrol. With comparatively developed systems of procurement and rationing, prices are kept under control and equitable distribution brought about with minimum supplies. The more successful are procurement activities and more detailed the rationing, the more do needed imports approximate to the actual net deficit in internal supplies. The abolition of rationed distribution meant that in case Government desired to affect prices of foodgrains it had to do so in competition with private sources of supply. Government would have, for the purpose, to offer grain at all strategic points, in adequate quantities. It could not eliminate, as under rationing, the pressure of the demand of the richer consumers or of the speculative hoarders; neither could it, by compelling consumers as under rationing to buy what it had to offer, abolish or narrow differentials for preferred supplies. Government, acting through only their imported supply, could not equally control all prices and could give relief to special classes only through making available to them supplies of cheap imported grain which they would buy only because the internal supplies were priced very high. In a number of instances the supply of even cheap grain had to be heavily subsidized to marke it at what appeared to Government a fair price.

The inflation of currency during war time, which was at the root of most problems of the post-war period, was brought about by large

government deficits on either their own account or on account of the H. M. G. and other allied governments. This deficit-financing persisted for some months even after the end of the war and further increased the inflationary pressure and potential. The rise of prices till about the middle of 1943 was the result of an open inflationary movement. The rise was slowed in the second quarter of 1943 and from about the middle of 1943 to the end of the war the level of prices did not, as a whole, rise. These prices were kept under check chiefly through a detailed system of controls. During the same period, however, the currency in the country, nearly doubled itself. This together with the changes in the cost-price relations referred to above made the working of the system of controls more and more difficult. After the opening months of 1946 the pressure of currency on prices was not allowed to increase for almost a year and a half. The apparently large fall in Government expenditure during 1946–47 was achieved chiefly by reclassification of expenditure and there was little decrease in the total outlay of the Government of India during 1946–47 from the high level reached in war years. However, during this year Government budgeting, though it did not in any way relieve the pressure on prices through the creation of a revenue surplus, did not at least make it more difficult by adding to the currency for financing a deficit. The situation, however, worsened after the partition. This was partly because the many unforeseen expenditures that the Indian Union had to undertake after August 1947 could not be met completely from current revenues and also because the new Finance Minister, in planning revenue receipts and remissions, was evidently misled by the distinction between revenue and capital expenditure and did not give sufficient attention to the potential inflationary effect of his deficits on capital account. (The period between the middle of 1943 and the end of 1947 may be called the period of suppressed inflation. This suppressed inflation was converted into an open inflation by the policy of decontrol of prices of consumer goods adopted towards the end of 1947. The policy of decontrol synchronized with the time of mounting government expenditure and helped in its turn to increase government deficits. The additions to currency which resulted from the need of financing this additional expenditure may have given further impetus to the rise of prices in this open inflationary period, though the higher prices could have been sustained by the supply of money in existence even before the new additions.)

The large increase of prices that took place between November 1947 and July 1948 created grave discontent within the country and compelled Government to reconsider its policy. Hurried consultations with representatives of industry and labour and with economists and other experts were held during August and September and an announcement of change of policy was made in the first week of October. The main features of this policy were the reimposition of food controls, the

recontrol of the prices of essential consumer goods like cloth and sugar, the decision to close the gap between revenue and expenditure, the encouragement of industrial production by tax and other concessions, the limitation of dividends of companies and encouragement to small savings. The high level reached by prices in July 1948 and the continuous increase in prices were alarming facts and the change of policy was intended primarily to check the increase and to bring prices down. Government announcement of October 1948 included the following statement. "When the revised policy comes into full operation there should be a marked decline in the present level of prices". It happened that the rise of prices was actually stayed after September, 1948. Government spokesmen have expressed the view that the change of policy had succeeded in its aim. The aim itself was declared by the Finance Minister in December, 1948 as no more than an immediate stabilisation of the price level.

It is necessary to examine the various aspects of Government policy to see how far they affect the situation immediately and promise to give lasting results. The halting of the process of increase in prices appears to have been due in some measure to the announcement of the change of policy by Government. It is, no doubt, true that the process of increase in the prices of foodgrains would, any way, have slackened in September with the prospect of the new crop and that the prices of sugar and cloth had reached peak levels already. Even so, government announcements influenced the psychology of the public and traders and helped to confirm the trend towards temporary stabilisation. In relation to cloth and sugar the fixation of controlled or agreed prices at levels somewhat lower than the earlier peaks was also helpful in stabilising price indices. There is also no immediate danger of these prices again moving upwards rapidly. During October to April new supplies of foodgrains arrive in the markets and this leads always to keep prices in check. Prices of foodgrains may be expected to remain stable till April; their future course is, however, not certain.

The decision taken to reimpose food controls was merely to the effect that the system of controls abolished in December, 1947, should be fully brought into operation by October, 1949. The steps by which the gradual imposition would be brought about were not made clear. It is only in the two deficit provinces, Bombay and Madras, where complete decontrol had after all been not found possible, that reimposition of controls has been rapid or systematic. Elsewhere the position is obscure. The procurement operations in many of the surplus provinces do not appear to be making much headway. The marketing of the harvests of the agricultural season 1948-49 should come at an end by May, 1949. If by that time no attempts have been made to procure a large proportion of the new supplies of grain by Government, these supplies will pass inevitably into the hands of the trading community. When this

happens it is difficult to see how Government will be able to control movements towards a rise in the price of foodgrains.

The prices of foodgrains hold a strategic position in the structure of price levels in India; if they are not successfully restrained, the holding down temporarily of the prices of cloth and sugar will not have much effect. How far will the other aspects of Government policy help in keeping food and related prices down? The increase of prices in 1948 cut largely into the increased money incomes that wage earners and the salariat had been able to obtain in 1947. This fact would, of itself, help the stabilisation of prices by relieving the effective pressure of the increased money incomes on the market. On the other hand, the wage earners and the salariat had now a legitimate grievance that their standard of living had again been substantially lowered. They could be persuaded to wait for some time before demanding a fresh increase of salaries and allowances only in the hope that the change of government policy would bring prices back to levels of at least 1947. This has not happened and Government seems to be going back on its decision to attempt to lower prices. Therefore, with prices stabilised at the level of 1948, demands for increases in money incomes are being pressed and in many instances the increases have already been obtained. A general increase in the money incomes of wage earners and the salariat will help to sustain another movement of price increases if it gets started.

The tax concessions given to industry by Government have little importance as an immediate anti-inflationary factor. The volume of extra production brought about by these means will not be available immediately in sufficient volume to set in motion any general movement of prices. The concessions have, however, a significance as part of the general trend of official policy. The announcement regarding industrial policy made by Government in April 1948 contained the following statement. "The system of taxation will be reviewed and readjusted where necessary to encourage saving and productive investment and to prevent undue concentration of wealth in a small section of people." Taxation as an instrument of combating concentration of wealth cannot be successful in India because of the high degree of such concentration and of the general practice of tax evasion. However, even if the instrument had been efficacious, government seems to have definitely decided not to use it for the purpose. Government has been so impressed by the need to stimulate industrial production and investment that it is now following the policy of encouraging high industrial prices and lowering the taxation on higher personal incomes and on business profits. The trend has been consistent in this direction since the first budget of the Indian Union and is marked also in the latest budget. A counterpart of this is the higher levels of indirect taxation. It is not clear that the relief given to higher personal incomes and business profits will necessarily be anti-inflationary. Not all the extra incomes left to the rich will be

saved; to the extent that they lead to increased consumption the effect will be inflationary. Similarly the outlay through additional business investment will be anti-inflationary only if it brings about an immediate increase in the supply of consumable goods. On the other hand, increased indirect taxation should increase the pressure of the demand for increased money incomes by wage earners and others.

Finally, there remains to be considered the assurance regarding the balancing of budgets. The latest performance in this respect has been highly disappointing. The budgets of many provinces are deficit budgets or budgets balanced only with increased indirect taxation. The Central revenue budget shows the dual feature of lowered direct taxation and increased indirect taxation. The most alarming phenomenon is, however, the large uncovered gap for 1948–49 revealed by the Central budget together with the proposal for another deficit for 1949–50. That these deficits are shown in the capital budget modifies the situation in no way. Mr. Sovani's discussion of this point appears to have been specially called for in view of the budget for 1949–50 and its defence by the Finance Minister of the Government of India. It is not clear how these deficits will be immediately covered. Whatever the means chosen for the purpose their ultimate effect must necessarily be inflationary.

To conclude, neither the control, nor the taxation nor the budgetary policy of Government is such as to inspire confidence and the budget deficits of the Central Government seem bound to make for aonther inflationary movement in the future. The immediate prospect depends on the ability of Government to restrain an increase in food prices after April-May, 1949 and the ability of Government and of employers in general to resist the pressure for increasing wages, salaries and allowances. If Government is unsuccessful in these two directions it will not be able, as indicated by its record so far, to hold down industrial prices either. There is little in the internal situation to lead to the expectation that stabilization of internal prices has been or will be definitely attained. The chief hope of succeeding immediately even in stabilising prices seems to lie in the direction of international forces. If a recession in the prices of primary products takes place abroad, especially in the U. S. A., the pressure on our foodgrains and oil seeds and cotton prices may be diminished. An extension of the downward trend of prices to industrial products may also lead to resistance on the part of employers to demands for increase in wages which might prove successful if increasing unemployment emerges because of actual or potential recession. Prices may then remain stable or fall not because of increased productive activity but because of a curtailment of employment. Such a turn of events, which is not entirely to be discounted, will of course not solve the economic problem but merely change its aspects. Government, with its present administrative complement and its present frame of mind, will be even more

powerless in the face of a threat of depression than it has been in dealing with inflation. A significant fall in the prices of primary products may lead to an agricultural depression and to an early loss of the gains in relation to indebtedness, etc. made by peasants during recent years. The policy of the limitation of government committments could, in the event, be successfully pursued. In such a situation the controls over industrial prices may still be retained but then they will be used, as before, to protect the profits of the trading and the industrial classes.

5 March 1949.
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POST-WAR INFLATION IN INDIA - A SURVEY

I INDIAN ECONOMY AT THE END OF WORLD WAR II

§ 1. *Introductory.*—Indian economy at the end of World War II could be aptly described as a controlled economy. It had slowly evolved during the war. The inflationary methods of war finance followed by the Government of India gave rise to a deficit-induced fiat money inflation in the country.[1] When it was realised that it was hampering the war effort the Government of India adopted an anti-inflationary policy and introduced a variety of economic controls. As a result the economy had, towards the end of the war, gradually settled down to the regime of controls and the inflationary forces had been brought under control to a considerable extent. For a proper appraisal of the Indian economy at the end of World War II a somewhat detailed presentation of statistical data bearing on some of its salient features is called for.

§ 2. *War Finance.*—It is pertinent to begin with war finance which was the main factor influencing the economy. Table 1 gives an estimation of the inflationary gap in Indian finances for the period 1939–40—1945–46.[2]

The inflationary gap works out at about Rs. 1,080 crores. Nearly the whole of it, Rs. 1,033 crores, was covered by expanding currency. Total notes issued expanded from Rs. 206 crores at the beginning of World War II to Rs. 1,154 crores at the end of it. Sterling securities in the Issue Department of the Reserve Bank of India, serving as its cover, recorded an increase from Rs. 59·50 crores to Rs. 1,034·32 crores during the same period. During the last two years of the war the rate of the accrual of sterling to the Government of India slackened to some extent because of the direct sales of gold in India undertaken by the U. K. and the U. S. A. Governments from the proceeds of which a part of their war expenditure (about Rs. 135 crores) was met. On a rough estimate these gold sales avoided or prevented the accrual of about £ 100 million to the Government of India.[3] During the last two years of the

1 For details cf. Gadgil-Sovani, *War and Indian Economic Policy*, 2nd edition (Publication No. 10, Gokhale Institute of Politics and Economics.)

2 For explanation of inflationary gap, etc. cf. Ibid.

3 Besides this the procedure that had been followed by the U. K. and the U. S. A. Governments with regard to these gold sales involved profiteering and a scaling down of sterling balances. The point has been very succinctly put in the *World Economic Survey*, 1942–44, of the League of Nations thus: "In most countries (e. g. Egypt and Mexico) the gold sales have been made by the United Kingdom and the

(*Continued on next page*)

TABLE 1—INFLATIONARY GAP IN INDIAN FINANCES DURING 1939-46

In Crores of Rupees

Assets	1939-40 to 1945-46	Liabilities	1939-40 to 1945-46
Central Government Revenue	1,461·97	Central Government .	
Total Government Loans	1,235·95	Total Outlay	2,235·91
Treasury Bills outstanding on 31st March, 1946.	83 33	Recoverable war expenditure, holdings, etc.	1,739·73
	2,781·25	Total Government outlay	3,995 80
Rupee finance directly raised by the Allies in India by Gold Sales (Approximate).	135·00		
	2,916·25		
INFLATIONERY GAP	1,079·55		
Increase in total notes issued.	1,032 72		

war the balances of the Government of India increased at a rapid rate and at the end of the financial year 1945–46 they amounted to Rs. 521·01 crores. These balances represent the net effects of various transactions of Government over a long period of years, whether revenue or capital or of a banking character. In the cash balances are merged the balances of various funds and deposits of a diverse character such as Depreciation etc. Funds, Ad Hoc Funds for Development, special repayable deposits, like those of the E. P. T , etc. The balances thus represent sums already provided for in the budgets whose expenditure was deferred. They were not additive to the total government outlays during that period.

§ 3. *Bank Deposits.*—The demand and time deposits of the scheduled banks increased from Rs. 247·86 crores to Rs. 892·18 crores in that period.

(*Continued from last page*)

the central banks of the countries concerned at the official prices, and where these central banks have resold part or all of the gold to the public, they have done so on their own account and have reaped the profits due to the premium. In the case of India and Iran, however, the sales to the public, though made largely through the agency of the central banks, were made on account of the United States and U. K. Governments so that these Governments took the profits. In the latter case, the proceeds in terms of rupees of a given number of pounds sterling or U. S. dollars, by first being converted into gold (whether taken from existing reserves or from gold bought from South Africa out of new production) and then changed into rupees, have been that much higher than would have been the proceeds of the same number of pounds or dollars added to the balances of India in London " For further details see N. V. Sovani, "Some Aspects of Post-War Indian Currency Problems", *Perspective*, April 1946.

TABLE 2.—AREA AND YIELD OF PRINCIPAL CROPS IN INDIA DURING 1939-46.

(Source:—Estimates of Area and Yield of Principal Crops 1936-46 Directorate of Economics & Statistics, Ministry of Agriculture, Govt. of India),

Crop		Average for 1936-37—1938-39	Average for 1939-40—1942-43	1943-44	1944-45	1945-46
Principal Food Grains :	Area (000 Acres)	19,32,52	19,39,78	20,66,90	22,59,95	21,93,72
	Production (000 tons)	5,52,68	5,43,99	6,04,55	5,98,56	5,42,10
Edible Oil seeds :	Area (000 Acres)	1,79,58	1,82,96	1,96,21	2,02,93	1,97,44
	Production (000 tons)	45,47	45,77	51,91	52,83	47,73
Non-edible Oil seeds :	Area (000 Acres)	50,64	46,06	50,76	49,33	47,65
	Production (400 tons)	5,55	5,25	5,21	5,23	4,86
Cotton :	Area (000 Acres)	2,46,65	2,20,61	2,10,86	1,48,43	1,46,68
	Production (000 bales of 400 lbs each)	56,53	54,78	52,59	35,80	35,30
Sugarcane :	Area (000 acres)	38,13	38,38	42,34	41,54	38,25
	Production (000 tons)	50,89	49,75	58,48	54,81	54,16
Tea :	Area (000 acres)	8,34	8,35	8,38	8,38	8,39
	Production (000 lbs)	42,57,98	49,28,58	57,37,74	51,13,89	57,49,91
Jute :	Area (000 acres)	29,80	35,80	26,40	21,04	24,22
	Production (000 bales of 400 lbs. each)	83,62	93,54	69,90	58,89	77,91
Tobacco :	Area (000 acres)	12,54	12,70	10,19	10,65	12,20
	Production (000 tons)	4,89	4,66	3,76	4,05	4,24

TABLE 3.—INDUSTRIAL PRODUCTION IN INDIA FROM 1939 TO 1946

(*Source*—Survey of Business Conditions in India).

Year	Jute manufactures	Cotton Manufactures	Cotton Piece Goods	Cement	Sulphuric acid	Sulphate of Ammonia	Wheat Flour	Sugar	Paper	Matches	Pig iron	Steel ingots	Finished Steel*
	Tons (000)	Million	Million yards	Tons (000)	Cwt. (000)	Tons	Md (000)	Cwt. (000)	Cwt, (000)	Gross Million	Tons (000)	Tons (000)	Tons (000)
1	2	3	4	5	6	7	8	9	10	11	12	13	14
1939 . .	1179 02	900·47	4114·00	N. A.	579 28	19745	16417·20	13910	1311 83	21 58	1757·04	1015·46	1025·62
1940 . .	1233 85	921·98	4812·15	N. A.	409·19†	13847†	15998 50	23649	1677·16	22 33	1994·10	1246·96	1187·35
1941 . .	1193 98	1087·13	4530·50	N. A.	N. A.	N. A.	18801·10	24201	1854·04	18·97	2009·60	1369·20	1359·60
1942 . .	1081·59	951·58	4024·70	1608·4‡	581·719‡	19874‡	14434·15	17703	1809 48	14·85	1829·70	1293·90	1271·70
1943 . .	965 79	1176·09	4751·10	2118·2‡	864·700	21924	12870·78	21540	1791·37	17·04	1747·70	1352·20	1314·70
1944 . .	995·10	1201·63	4857·20	2048 8	552 723	23521	11651·42	21065	1524 06	17·69	1419·25	1310·79	1298·90
1945 . .	1079 50	1200·59	4685·3§	2209·80	443·95	21898	14575·96	17167·70	1618 14	22 68	1420·43	1265·48	1317·26

*Including semis but excluding bloom, billets and slabs.

N. A.—Not availble.

† Relates to January–July 1940 only.

‡ Relates to April–December 1942 only.

§ Provisional.

The publication of production figures for Sulphuric Acid and Sulphate of Ammonia was discontinued for some time due to exigencies of the war.

The ratio of clearings to scheduled banks' demand liabilities declined from 16·7 in 1939–40 to 9·2 in 1942–43 and remained roughly at that level thereafter till the end of the war.

§ 4. *Production.*—Tables 2 and 3 set out the data regarding agricultural and industrial production in India during the war period. The total area under crops did not increase to any substantial extent in the war period. The per acre yields also did not show any trend towards a general increase. Area and production of food crops showed a marked increase paralleled by an equally marked decline in the acreage and production of cotton. The increase in the acreage under foodgrains was partly the result of increase in area sown more than once and mainly of diversion from cotton to foodgrains. There was little or no diversion from oilseeds to foodgrains. The area under edible oilseeds increased by about 11 per cent. over the pre-war average but that under non-edible oilseeds declined slightly.

Industrial production showed more elasticity and considerable increases in certain lines were recorded. The peak level production in cotton manufactures, steel ingots and finished steel was around 33 per cent. over the 1939 level. Production peaks in sugar, sulphuric acid and matches were even higher. In connexion with the general level of industrial production the production and supply of power is of vital importance. The position in this regard can be gauged from the following figures of coal raisings and electrial energy generated in India during the war.

Year	Coal Raisings (000 tons)	Electrical Energy (Million Units) Generated	Sold
1939–40	25,056	2139·3	1837·7
1940–41	26,005	2453·4	2057 3
1941–42	26,463	2828·1	2401·6
1942–43	25,470	2854·6	2414·6
1943–44	22,483	3126·3	2649·0
1944–45	24,154	3425·6	2887·9
1945–46	26,489	3573·4	3008·0

Coal-raisings declined from their peak level in 1941–42 upto 1943–44, recording a fall of about 15 per cent. There followed a rise and in 1945–46 the wartime peak was slightly exceeded. Electrical energy generated and sold showed a steady rise throughout the war, recording an increase of about 70 per cent. over the 1939–40 levels.

§ 5. *Prices.*—Table 4 sets out the Economic Adviser's index of wholesale prices and the cost of living index in four important cities in India during the war period. While the general index of wholesale

prices stood at 244·1 at the end of the war that for agricultural commodities was at 268·0. During the early years of the war the movement of prices was led by the movement in the prices of manufactured articles. With the deepening of the food crisis in the country in 1942–43 the prices of agricultural and primary commodities came to dominate the price level and largely governed its rise and fall in the later years. Apart from these movements of constituent indices, the broad picture of war-time price movements is one of a rapid increase in all sectors from 1940–41 to 1943–44 and then a comparative stabilization at a slightly higher level upto the end of the war and some months after it. The cost of living indices for the four cities show unequal rises during the war period.

TABLE 4—INDICES OF WHOLESALE PRICES AND THE COST OF LIVING IN INDIA, DURING THE WAR PERIOD (Base 19 August 1939 = 100)

(Source–Monthly Survey of Business Conditions in India)

Year	Agricultural commodities.	Raw Materials	Primary commodities	Manufactured Articles	Chief articles of export	General Index	Cost of Living Indices.			
							Bombay	Madras	Lahore	Cawn-pore
1939–40*	127·5	118·8	124·2	131·5	130·5	125·6	105	106	110	108
1940–41	108·6	121·5	113·4	119 8	114·1	114·8	109	110	108	110
1941–42	124·2	146 9	132·5	154·5	137 3	137·0	122	116	130	132
1942–43	166·2	165·9	166·0	190·4	161·7	171·0	166	148	199	203
1943–44	268 7	185 0	232 5	251·7	236·4	236·5	226	189	291	322
1944–45	265·4	206·0	240·5	258·3	243·9	244·2	225	212	280	317
1945–46	272·6	210·0	246·2	240·0	248·9	244·9	228	229	292	310

* 7 months ended March 1940.

§ 6. *Employment and Wages.*—Data regarding factory employment in India during the war period is set out in Table 5. The total factory employment in the country increased by about 50 per cent. during 1939–45. The largest increase occurred in the employment in Government and Local Fund factories, the net increase in the number employed amounting to 324,567 or 246 per cent. over that at the beginning of the war. Employment in other factories increased from 16·2 lakhs in 1939 to 21·9 lakhs in 1945, an increase of 35 per cent. Along with the expansion in factory employment there was also enormous expansion in the employment in armed forces. India's armed forces increased from below 2 lakh troops before the war to more than 20 lakh troops during the war period.

TABLE 5.—AVERAGE DAILY NUMBER OF WORKERS EMPLOYED IN THE FACTORIES IN BRITISH INDIA DURING THE YEARS 1939 TO 1945 CLASSIFIED ACCORDING TO INDUSTRIES.

(Source—Indian Labour Gazette).

Industries	No. of Workers						
	1939	1940	1941	1942	1943	1944	1945
1 Textiles ...	819,404	831,801	956,038	968,531	1,004,546	996 396	1,014,309
2 Food, Drink and Tobacco ...	247,630	261,544	280,435	283,830	292,917	294,809	309,686
3 Gins and Presses ...	163,226	158,848	163,994	151,699	141,303	143,417	129,467
4 Engineering ...	159,761	170,508	217,882	244,154	280,662	300,395	314,688
5 Paper and Printing ...	56,932	59,018	61,000	61,809	64,957	67,502	72,271
6 Chemical, Dyes etc. ...	57,966	59,280	73,430	74,171	84,519	90,749	101,687
7 Railway Workshops ...	55,784	61,454	69,098	89,818	101,875	121,684	116,549
8 Minerals and Metals ...	55,123	62,357	76,162	82,493	92,694	91,126	125,457
9 Wood, Stone and Grass ...	53,084	60,287	78,812	83,598	92,180	100,409	106,857
10 Ordnance Factories ...	30,709	49,999	76,488	113,077	131,076	158,327	185,605
11 Skins and Hides ...	12,906	18,097	23,516	29,608	33,660	34,624	36.301
12 Miscellaneous ...	36,455	42,291	60,367	70,948	86,555	98,377	107,253
Total ...	1,751,137	1,844,428	2,156,377	2,282 288	2,436,312	2,522,753	2,642.977

TABLE 6.—AVERAGE ANNUAL EARNINGS OF EMPLOYEES IN FACTORIES DURING 1939-1945.

(Source-Indian Labour Gazette) *Rupees*

Industry	1939	1940	1941	1943	1944	1945
1 Textiles	293·5 (100 0)	302·9 (103·2)	314·0 (107·0)	571·5 (194·7)	633 6 (215·9)	613·7 (208·9)
2 Engineering	263·5 (100 0)	345 0 (130·9)	371·5 (141·0)	529·0 (200·7)	589·8 (223 8)	653·1 (247·9)
3 Minerals & Metals	457·2 (100 0)	491·5 (107·5)	476 1 (104·1)	502·1 (109 8)	573·5 (125·4)	601·9 (131·6)
4 Chemicals & Dyes	244·8 (100 0)	229·6 (93·8)	238 1 (97 3)	398·0 (162·6)	484·6 (198·0)	445·2 (181·8)
5 Paper & Printing	332·7 (100·0)	360·0 (108·3)	324·8 (97·6)	414·0 (124·4)	474·7 (142·5)	568·8 (170·1)
6 Wood, Stone & Glass	194·2 (100·0)	175·3 (90 4)	199·1 (102·6)	303·1 (156·2)	368·4 (189·9)	413·6 (213·2)
7 Skins & Hides	285·8 (100 0)	327 1 (114·5)	357 9 (125·2)	411·0 (143·8)	532 1 (186·2)	536 7 (186 8)
8 Ordnance Factories	361·9 (100·0)	408·5 (112 9)	429·4 (118·7)	527·4 (145·7)	546·8 (151·1)	642·8 (177·6)
9 Mints	367·4 (100·0)	462·7 (125·9)	491·2 (133·7)	574·4 (156 3)	695 2 (189·2)	667·0 (181·6)
10 Miscellaneous	281·2 (100·0)	261·0 (92·8)	261·2 (92·9)	392·0 (139·4)	513·8 (182·7)	503·2 (178 9)
All Industries	287·5 (100·0)	307·7 (107·0)	324·5 (112·9)	525·0 (182·6)	586·5 (204·0)	595·8 (207·2)

This must be considered along with the movement of wage rates during that period. Table 6 sets out the relevant information. The highest percentage increase during the war period "has been in Engineering being of the order of 147·9 followed fairly closely by the increases in Wood, Stone and Glass (113·2) and Textiles (108·9). The lowest percentage increase as compared to pre-war is shown by Minerals and Metals but this may be partly due to the fact that in this group during 1939 the average annual earnings were the highest in the country. It will be seen from the table that there was a sharp rise in the average annual earnings in 1943 but in 1944 and 1945 the level of earnings was more or less stable being about 100 per cent. more than pre-war".[4] If the rise in average earnings and the cost of living in different parts of

4 *Indian Labour Gazette*, September 1947, p. 163.

the country are taken into account it will be seen, obcserves the *Indian Labour Gazette*, "that the increases in the average earnings have lagged considerably behind the ~~earnings~~ in the cost of living as compared to pre-war".

§ 7. *Economic Controls.*—A variety of economic controls were introduced during the war period particularly during and after 1943. India began as the European countries had during 1914-18 with *ad hoc* controls adapted to meet only immediate needs and extended as new emergencies arose. There was never any concerted effort on the part of Government to co-ordinate or integrate these variety of controls. "Controls over the production and prices of most important types of producer goods came comparatively early. These were necessary because of the need for either the conservation of supplies or the canalization of productive resources. The production of a number of important consumer goods was also early controlled. In relation to industrial prices Government had undertaken considerable control even earlier than the launching of the anti-inflationary campaign. These controls, together with measures subsequently introduced, now (1944) cover a very large portion of capital and durable goods and materials required by the producers. The machinery and the cotton and jute industries are controlled in respect of both prices and distribution. The distribution of iron and steel products, and specifically those of machine tools, has been regulated for a considerable time, and wireless and electrical apparatus has been more recently brought under control. Chemicals and drugs, most metals, motor vehicles and accessories, rubber and rubber manufactures are similarly controlled and the distribution of coal was one of the first to be brought under a systematic arrangement of priorities. Paper, cement and sugar industries are all subject to the decree of the state. The control over the prices of consumer goods was initially limited to a small number of commodities. Gradually this was extended, but it was really with the enactment of the Profiteering and Hoarding Prevention Ordinance that the whole field might be said to have been covered."[5]

The controls over the production, distribution and consumption of food were perhaps the most detailed and comprehensive. The production of foodgrains was made compulsory in many areas in the country and their prices were controlled. In most areas in the country government monopoly of purchase of food grains was established. Procurement was in some areas carried out by the device of a compulsory levy of food grains. An extensive system of rationing of food grains was introduced. In 1944, 26 million people were under rationing. This had increased to 52 million in 1945. The basic ration was 16 oz. per person. Feasts on a grand scale were banned and the number of courses restrict-

5 Gadgil and Sovani, op. cit, p. 148,

ed. Thus Government had assumed almost complete control over production, procurement, distribution and consumption of foodgrains by the end of the war.

The inability of the Government to take a firm stand against important interests affected vitally the prices of both agricultural and industrial products fixed under the various controls. As regards the first, the Government had to resist the pressure from surplus provinces, like the Punjab. In industrial prices the pressure of capitalist interests was equally irresistible. As a result all fixed prices became, and in fact were, negotiated prices. The fixation of prices in India during war-time was thus in sharp contrast to the practices in the U. K., the U. S. A. or Canada.

§ 8. *Expectations regarding transition and their failure.*—Towards the end of the war the majority of Indian economists felt that the problems of the transition from war to peace economy in India would be radically different from those in the Western countries. Instead of a boom they expected a considerable slackening of economic activity after the end of the war. The reasons leading to this conclusion were: firstly, for various reasons there was only a small amount of pent up effective demand generated during the war period and this was not likely to give rise to a boom. Secondly, barring a natural famine, agricultural prices were likely to develop a sagging tendency after the war. They had increased during the war because of inflationary pressure. After the war this pressure was expected to ease. As the bulk of the demand on the Indian market came from the agriculturists whose incomes would decline in the wake of falling agricultural prices this was most likely to lead to a collapse of the Indian market. Thirdly, the over-valued exchange rate would exert a downward pressure on Indian prices, as there was very little prospect of world prices rising sufficiently to neutralise even partially the overvaluation of the exchange rate. Fourthly, the demobilization of the army and the closing of government war factories would result in considerable unemployment. Lastly, there was likely to be a sharp decline in total government outlay after the war and this was likely to cut down economic activity very significantly.[6]

The statistical data presented in the next two Sections clearly show that the expectations regarding the transition problems were completely belied by actual developments. An analysis of the causes of this failure might usefully be attempted.

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6 cf. N. V. Sovani, Transition from War to Peace Economy in India, ***Indian Journal of Economics***, January 1945, Also other papers in the same issue on the same subject.

In expecting a considerable slackening of economic activity in the post-war period the major assumption more or less underlying all others was that monetary and fiscal policies will not be such as to further strengthen the inflationary forces in the country. The other assumptions partly dependent on this were, (i) agricultural production will be normal and, because of the stopping of inflation, agricultural prices will tend to fall. (ii) prices abroad will not rise and the overvalued Indian exchange will act as a damper on internal prices. (iii) Government outlay will fall considerably and the gap will not be filled by private outlays. (iv) Employment will fall and there will be no occasion for wage and salary increases because of the discontinuance of inflationary conditions. (v) Economic controls will not be slackened. The major assumption was made on the strength of the statements made then by the various Government spokesmen. The other assumptions were, as can be obviously seen, not unreasonable at the time at which they were made. No body could then expect a couple of grave famines or the development of inflationary conditions in major Western countries and the U. S. A.

As it turned out, the major assumption was completely set at naught by the government economic policy of the post-war period. The Government of India continued to finance the purchases of H. M. G. even after the end of the war, thus adding to sterling balances and subsequently to currency in circulation. Budget deficits persisted throughout the period, for though the revenue budgets were balanced the capital budgets were not thus increasing inflationary pressure all round. Secondly, the most inopportune cheap money drive launched in 1946 aggravated the situation still further. Thirdly, the undecided and half-hearted policy regarding the working and continuance of economic controls also strengthened inflationary forces. As a result of all this, the inflationary conditions in the country were very considerably accentuated.[7]

The continuance and accentuation of inflationary conditions coupled with the failure of crops in two successive seasons, kept the agricultural prices under great upward pressure. The failure of the crops was completely unexpected and unpredictable. The overvalued rupee exchange did not act as a damper on internal prices because of two

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7 There were some economists who maintained that during the period of transition India will in the first instance experience a boom and not a depression. They expected the boom to arise out of the accumulated wartime demand. cf *Indian Journal of Economics*, January, 1945. Some of these economists have recently claimed that their prognosis has come true. This is however not the case, for what has actually developed in India is not a *boom* as they predicted but an *inflation*. Even the latter has not resulted from the unleashing of accumulated wartime demand but from other unexpected developments

developments which were largely unexpected. Firstly, the world economic recovery proved to be unexpectedly prolonged and shortages in many lines unexpectedly persisted.[8] As a result in spite of the overvalued exchange the external demand for Indian raw materials was unexpectedly buoyant during the post-war period. The foreign demand for Indian short staple cotton is a case in point. The growing dollar shortage further accentuated this demand as India was in the soft currency area. Secondly, the U. S. Government policy with regard to price controls changed suddenly and all controls on prices in that country were removed. As a consequence the U. S. prices went up, the index of wholesale prices increasing from 123 in 1945 to 176 in 1947. The U. S. A. being economically the most influential country in the world the repercussions of this price rise were felt all over the world and prices in other countries, even where they were under rigid controls, also tended to increase. How the U. S. price rise upset the carefully laid plans of reconversion and made inevitable a substantial rise in prices can be seen by an examination of developments in Canada.[9] Contraray to expectations the total governmental outlays did not fall after the war, as the following figures show.

TOTAL GOVERNMENT OUTLAY IN INDIA DURING 1945-49

(Crores of Rupees)

	Undivided India		Indian Union	
	1945-46 (Accounts)	1946-47 (Accounts)	1947-48 Revised	1948-49 Budget Estimates
Central Government outlay charged to :				
Revenue	894·20	435·10	*185 29	272·37
Capital	...	563·24	*141·24	286·57
Provincial Governments' outlay charged to :				
Revenue	218·14	254·65	†211·08	258·27
Capital	...	...	...	51·64
Total ...	1,112 34	1,252·99	537 61	868 85

* 7^1 months.

† Expenditures of West Bengal and East Punjab for 7½ months only.

8 Recovery in European agriculture was prevented and retarded by the severe draughts in two successive years and unusually cold weather in 1947-48. As to how unusual these happenings were, see 18th *Annual Report of the Bank for International Settlements*. 1948 p. 24.

9 *Report of the Wartime Prices and Trade Board*, January 1, 1946 to December 31, 1947 including important developments upto February 1947.

Actually in the first post-war year the governmental outlays were higher by more than Rs. 100 crores than those during the previous year. If the figures for 1947–48 are adjusted for time and area and those of 1948–49 for area, it is clear that the relative level of governmental outlays did not fall significantly during those years. The budgets of the Central Government continued to show large deficits and, as discussed later, they were met partly by drawing on reserves and partly by fresh currency expansion. This could not but lead to a further strengthening of inflationary forces in the country.

Demobilization of the armed forces proceeded pretty fast during the first two years and by January 1947 more than 13 lakh men were released. Of these about 140,000 were placed in employment through the Employment Exchanges up to the end of February 1947. Demobilization slowed down considerably thereafter and after the partition of the country a new recruitment drive was launched. The average daily number of workers employed in the factories declined from 2·44 millon in 1945 to 2·23 millon in 1947, a decline of about 9 per cent. only. Because of the continuance of inflationary conditions, however, wages and dearness allowance rates were increased in many industries. The average annual earnings of employees in factories in 1947 recorded an increase of about 24 per cent. over those in 1945. As a result of the recommendations of the Central Pay Commission the pay scales of several categories of government servants were revised upwards. Pay scales in Provinces were also similarly raised. Internal income levels rose substantially in the wake of these increases and the rising prices of agricultural commodities. The investment outlays on private account also showed a rise.[10]

In the face of all these unexpected developments it is no wonder that the expectations regarding the transition were falsified.

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10 "Some evidence of an increase in private investment since the end of the war may be found in the figures for the production of cement and steel. As these are both products which were heavily in demand for military purposes during the war, they would tend to suffer from the decline in defence expenditure...The fact that there was no very great fall in output compared with the peak years of the war made it reasonable to suppose that private investment demands have considerably filled the gap left by the decline in military outlay." *Survey of Current Inflationary and Deflationary Tendencies*, Department of Economic Affairs, United Nations, 1947, pp. 69-70 Cement production recorded a sharp decline during 1947–48 over that of the preceding year but the fall in steel production during the same period was only slight.

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§ 9. *Wholesale Prices.*— Table 7 sets out the monthly index of wholesale prices in India issued by the Office of the Economic Adviser to the Government of India, during the period from September 1945 to August 1947. The General Index of wholesale prices increased from 242·2 in September 1945 to 299·3 in August 1947, showing almost a continuous rise during the period. The index recorded a sharp and sudden rise after September 1946, the rise in the following two months exceeding 18 points.

Among the groups constituting the General Index the highest increases were recorded by those of Export Commodities and Agricultural Commodities. The index of the prices of the latter group increased by 87 points during the period under review. It was marked up 24 points at the end of the period between November 1945 and March 1946. This rise was largely due to the increase of 232 points in the index of raw jute prices during this period. From November 1945 to March 1946 the indices of the prices of copra, groundnut and linseed were up by 175,63 and 58 points respectively. The index of agricultural commodities continued to mount in the following months but the pace was slow. A sharp increase came in October 1945 when the index rose by 19 points to 321·7 which was mainly due to the very sharp rise in jute prices after the decontrol of jute on 23 October 1946. The index rose to 336·0 in November 1946. Though there was a slight recession thereafter, the older level was again attained in March 1947. During November 1946 and March 1947 the indices of the prices of groundnuts, linseed and tea recorded increases of 106, 59 and 96 points respectively. During the same period indices of copra and tobacco prices recorded declines of 437 and 100 points respectively. Oilseeds.controls were lifted in March 1947. The index of the prices of Agricultural Commodities fluctuated around the level attained in March 1947 in subsequent months and in August 1947 rose sharply to 351·8.

The index of Raw Material prices was stable around 210 for some time after the end of the war. After fluctuating it came down to 207·4 in May 1946 and then rose suddenly to 245·7 in July 1946. This sudden increase was due to the sharp rise in the prices of tea, wool and raw hides and skins. The index declined slightly during subsequent months, rose to 248·8 in February 1947 and after fluctuating came down to 241·1 in August 1947. The index of the prices of Manufactured Articles showed a declining tendency after the end of the war and stood at 235·8 in December 1945. This decline was largely due to the reduction in the controll d prices of cotton textiles and jute manufactures during this period. The index then showed a moderately rising tendency and, mounted, after fluctuating, to 240·0 in June 1946. There was a sharp

TABLE 7—INDICES OF WHOLESALE PRICES AND COST OF LIVING IN INDIA FROM SEPTEMBER 1945 TO AUGUST 1947

(Source :—"Report on Currency and Finance." Reserve Bank of India 1947-48, and Indian Labour Gazette : Labour Bureau : Government of India, Ministry of Labour.)

(Base : Week ended 19th August 1939 = 100)

Year and Month	Agricultural commodities	Raw Materials	Primary Commodities	Manufactured Articles	Chief Articles of Export	General Index	Cost of Living Indices			
							Bombay	Lahore	Cawnpore	Madras
1945 September	264 2	210 8	241·9	242·9	246·2	242 2	229	279	320	231
October	268 7	210·8	244·5	242 9	248·0	244·1	230	284	318	230
November	271·1	210·8	245 9	236 0	246·4	243·6	230	291	317	230
December	278 5	211 7	250 3	235·8	249·1	247·1	230	293	310	229
January 1946	285·4	211·2	253 9	237 3	253 5	250 2	230	293	305	230
February	291·5	210·3	256·7	239·2	257·4	252·8	231	292	311	232
March	295 7	206 3	257·1	240·2	261·0	253·3	235	302	309	233
April	294·3	206·1	256·3	240·6	262·8	252·7	236	305	308	233
May	299·3	207·4	259·6	239·2	266·7	255·0	237	305	309	237
June	302 8	226 4	270·5	240·0	279·9	263·5	247	294	321	240
July	303 8	245·7	275·7	250 5	289·5	270·1	255	298	351	242
August	303 5	240·7	277·3	250·2	291 2	271·3	254	303	346	242
September	302·2	243·2	277·7	248·6	289·0	271·1	257	308	316	239
October	321 7	239·8	286·9	262·9	303·2	281·5	251	309	340	240
November	336 0	237·3	293·6	275·6	313 4	289·6	250	319	350	248
December	326 0	235·8	287·5	277·8	310 7	285·4	266	326	345	254
January 1947	314·6	243 0	284·5	279·9	313·4	283·5	254	319	348	256
February	324·8	248·8	291·1	277·0	322·6	289·2	250	323	346	259
March	335 8	247·1	298·1	274·3	327·4	292·7	256	323	341	272
April	338·2	246 2	298·9	269·5	...	292·2	257	323	342	277
May	333·7	243·4	295·2	271·6	...	289·9	258	327	349	274
June	340·8	234·6	294·7	276·8	...	290·5	265	...	368	274
July	350 3	238·9	301·8	278·6	...	296·6	2 1	...	401	276
August	351·8	241·1	303·7	284·3	...	299·3	270	...	410	276

TABLE 8—INCREASE OR DECREASE IN CURRENCY IN CIRCULATION IN EACH MONTH FROM SEPTEMBER 1945 TO AUGUST 1947

(Source :—Reserve Bank of India Bulletins) (Lakhs of Rupees)

Month and Year	Circulation at the end of the period			Increase (+) or decrease (−) in circulation				Progressive increase (+) or decrease (−) in total notes issued since sept 1945
				Notes		Rupee Coin		
	Notes	Rupee Coin	Total 1+2	During the month	progressive from Sep. 1945	During the month	progressive from Sep 1945	
	1	2	3	4	5	6	7	
Sept 1945	1,141,84	148,30	1,290,14	+2,39	...	−72	...	...
October	1,156,13	148,91	1,305,04	+1,429	+16,68	+61	−11	+565
November	1,176,37	149,38	1,325,75	+2,024	+36,92	+47	+36	+24,73
December	1,210,89	149,78	1,360,67	+3,452	+71,44	+40	+76	+48,51
January 1946	1,199,69	158,18	1,358,17	−1,120	+60,21	+8,70	+9,46	+78,17
February	1,195,90	164,30	1,360,20	−3,79	+56,45	+5,82	+15,28	+81,07
March	1,218,77	165,73	1,384,50	+2,287	+79 32	+1,43	+16,71	+76,78
April	1,232,74	166,67	1,399,41	+1,397	+93,29	+94	+17,65	+84,07
May	1,233,99	168,30	1,402,29	+1,25	+94,54	+1,63	+19,28	+88,05
June	1,237,84	171,10	1,408,94	+3,85	+98,39	+2,80	+22,80	+92,45
July	1,215,46	169,11	1,384,57	−2,238	+76,01	−1,99	+20,09	+92,51
August	1,206,78	168,88	1,375,66	−8,68	+67,33	−23	+19,86	+94,00
September	1,187,85	167,32	1,355,17	−1,893	+48,10	−1, 6	+18 30	+95,44
October	1,195,17	166,62	1,361,79	+7,32	+55,72	−70	+17,60	+96,38
November	1,200,98	165,61	1,366,59	+5,81	+61,53	−1,01	+16 59	+97,01
December	1,224,57	167,32	1,391,89	+2,359	+85,12	+1,71	+18,30	+96,71
January 1947	1,225,76	167,14	1,392,90	+1,19	+86,31	−18	+18,12	+96,31
February	1,229,67	167,75	1,397,41	+3,91	+90,22	+61	+18,73	+95,61
March	1,242,03	167,67	1,409,70	+1,236	+102,58	−8	+18,65	+95,59
April	1,239,81	167,94	1,407,76	−2,22	+100,36	+27	+18,92	+99,63
May	1,227,03	166,71	1,393,74	−1,278	+87,58	−1,23	+17,69	+101,62
June	1,221,51	165,57	1,387,08	−5,52	+82,06	−1,14	+16,55	+102,38
July	1,193,63	162,55	1,356,19	−2,788	+54,18	−3,02	+13,53	+104,24
August	1,180,58	160,62	1,341,19	−1,305	+41,13	−1,93	+11,60	+107,02

increase during subsequent months and in January 1947 the index touched 279·9. This rise was mainly due to the substantial increase in the prices of leather and jute manufactures which followed in the wake of the sharp rise in the prices of raw hides and skins and raw jute.

§ 10. *Currency.*—During the period September 1945 and August 1947 the total notes and coins in circulation increased by Rs. 50·34 crores. Of this Rs. 38·74 crores were notes and the rest rupee coins. The data regarding their movement month by month during the period are set out in Table 8. The notes in circulation increased from Rs. 1147·14 crores in September 1945 to Rs. 1241·97 in June 1946 and then declined during the next four months, touching Rs. 1197.09 in October 1946. There was a continuous rise from that level to Rs. 1247·28 crores in April 1947 after which there was a steady decline to Rs. 1120·40 crores in August 1947.

Table 9 sets out the assets of the Issue and Banking Departments of the Reserve Bank of India during September 1945 and August 1947. The sterling securities in the Issue Department of the Reserve Bank of India increased from Rs. 1042·32 crores in September 1945 to Rs. 1135·32 crores in June 1946 and remained steady at that level during the subsequent months. Rupee coin dropped from Rs. 17·70 crores in October 1945 to Rs. 12·47 crores in January 1946 and then, with occasional fluctuations, increased to Rs. 31·32 crores in August 1947. Gold coin and bullion and rupee securities remained unchanged throughout the period. Among the assets of the Banking Department the movements under "balances held abroad" during this period are significant. These increased from Rs. 485·46 crores in September 1945 to Rs. 607·10 crores in April 1946 and then steadily declined to Rs. 383·09 in August 1947. The continuous increase in the sterling assets of the Reserve Bank of India during September 1945 and June 1946 was due to the continuance of the wartime arrangement by the Government of India of financing the purchases of His Majesty's Government in India. The increase in the sterling assets of the Issue Department of the Reserve Bank of India was paralleled by an almost equal rise in the total notes issued. In a joint statement on 4 February 1946 leading economists in India had protested publicly against this policy. The trend was reversed during the subsequent period and the sterling assets of the Reserve Bank were drawn upon to finance the imports of goods into the country.

§ 11. *Bank deposits.*—Table 10 gives the consolidated position of scheduled banks for each month during the period September 1945–August 1947. The demand liabilities of scheduled banks increased from Rs. 643·68 crores in September 1945 to Rs. 751·78 crores in November 1946 but declined from then onwards to Rs. 667·77 crores in May 1947. In August 1947 they stood at Rs. 686·27 crores. Time liabilities increased by Rs. 95·33 crores during September 1945–May 1947 and the increase

TABLE 9 —ASSETS OF THE ISSUE AND THE BANKING DEPARTMENTS OF THE RESERVE BANK OF INDIA FROM SEPTEMBER 1945 TO AUGUST 1947.

(Source:—Reserve Bank of India Bulletins.) *In Lakhs of Rupees.*

Month and Year	Issue Department				* Banking Department						
	Gold coin and Bullion	Sterling Securities	Rupee Coin†	Rupee Securities	Notes and Coin	Balances held abroad‡	Loans and advances to Governments	Other Loans and advances	Bills purchased & discounted	Investments	Other Assets.
Sept. 1945	44,42	1,042,32	17,30	57,84	15,07	485,46	...	...	3,86	22,79	5,96
October	44,42	1,047,57	17,70	57,84	10,81	519,23	4	..	1,65	21,72	5,69
November	44,42	1,067,32	17,03	57,84	11,22	547,31	12	3	21	19,95	6,78
December	44,42	1,093,07	15,06	57,84	10,66	558,82	33	36	2,39	22,28	8,25
Janu 1946	44,42	1,125,32	12,47	57,84	20,18	549,17	21	95	7,18	32,30	9,21
February	44,42	1,127,82	12,87	57,84	48,59	560,21	8	3	2,90	37,61	12,77
March	44,42	1,123,32	13,08	57,84	22,10	597,16	...	10	1,93	31,92	15,23
April	44,42	1,124,07	19,62	57,84	11,01	607,10	...	9	5,15	35,16	17,92
May	44,42	1,129,32	18,35	57,84	13,14	594,27	...	8	5,57	35,52	19,29
June	44,42	1,135,32	16,75	57,84	12,61	574,10	20	5	55	30,23	15,53
July	44,42	1,135,32	16,81	57,84	29,49	562,38	...	6	15	23,54	17,70
August	44,42	1,135,32	18,30	57,84	41,75	564,96	...	1,53	69	14,54	18,80
September	44,42	1,135,32	19,74	57,84	59,23	530,67	...	3,59	2,69	16,22	18,45
October	44,42	1,135,32	20,68	57,84	61,40	505,69	18	1,00	1,91	16,41	21,55
November	44,42	1,135,32	21,31	57,84	57,86	488,34	...	23	2,21	22,98	24,53
December	44,42	1,135,32	21,01	57,84	40,09	485,76	14	27	51	35,00	25,91
Janu. 1947	44,42	1,135,32	20,61	57,84	27,68	478,09	8	2,39	2,13	46,37	27,26
February	44,42	1,135,32	19,90	57,84	23,12	474,49	1	8	3,13	48,03	29,06
March	44,42	1,135,32	19,89	57,84	14,57	477,54	...	17	2,92	58,29	29,87
April	44,42	1,135,32	23,93	57,84	14,35	475,76	36	23	3,31	67,18	10,35
May	44,42	1,135,32	25,92	57,84	28,74	472,60	82	25	3,55	58,55	5,15
June	44,42	1,135,32	26,68	57,84	35,27	449,46	3,66	11	1,49	70,39	5,77
July	44,42	1,135,32	25,83	57,84	56,60	410,93	6,63	23	3,73	69,93	5,00
August	44,42	1,135,32	31,32	57,84	78,59	388,09	1,22	32	6,27	80,62	4,59

† Including Government of India One Rupee notes from July 1940.

* Capital and Reserve-Rupees Ten Crores.

‡ Including Cash and Short-term Securities.

TABLE 10.—CONSOLIDATED POSITION OF THE SCHEDULED BANKS IN INDIA FROM SEPTEMBER 1945 TO AUGUST 1947

(Source :—Reports on Currency and Finance : Reserve Bank of India).

In Lakhs of Rupees.

Month and Year	Demand Liabilities	Time Liabilities	Savings Deposits	Total demand and time Liabilities	Cash	Balance with the Reserve Bank of India	Excess of 7 over the statutory maximum	Total cash & Balances with the Re. Bank	Advances	Bills discounted	Total advances & Bills discounted
1	2	3	4	5	6	7	8	9	10	11	12
Sept. 1945	643,68	254,18	10,691	897,86	33,82	111,12	74,16	145,24	251,41	13,34	264,75
October	655,43	261,27	109,86	916,70	34,91	108,61	70,61	143,52	249,66	13,26	262,92
November	668,87	268,71	111,98	937,58	38,22	92,75	53,91	127,97	258,26	16,09	274,35
December	681,31	277 21	111,71	958,32	37,28	77,60	37,99	114,88	295,02	20,31	315,33
Jan. 1946	688,49	281,95	117,91	970,45	40,77	82,87	42,81	123,64	319,17	20,38	339,55
February	705,68	292,98	120,48	998,66	40,02	102,64	61,50	142,66	316,11	19,28	335,39
March	703,65	296,00	121,56	999,65	36,27	81,48	40,32	117,69	341,54	19,45	360,99
April	700,91	300,99	123,38	100,190	36,71	75,01	33,94	111,72	366,40	21,71	388,11
May	707,02	307,01	125,33	1,014,03	36,82	87,42	45,93	124,24	373,44	20,46	393,90
June	711,17	310,89	126,92	1,022,06	40,47	101,78	60,00	142,25	364,63	20,39	385,02
July	721,80	312,08	128,13	1,033,88	41,06	103,95	61,62	145,01	363,40	18,95	382,35
August	740,36	31,629	130,01	1,056,65	44,60	80,80	37,46	125,40	388,36	19,10	407,46
Septem.	749,69	320,02	131,97	1,069,71	45,05	80,74	36,86	125,79	395,26	20,26	415,52
October	746,51	323,05	132,61	1,069,56	40,33	77,99	34,20	118,32	393,90	20,14	414,04
November	751,78	331,11	133,68	1,082,89	42,34	78,74	34,53	121,08	412,89	22,51	435,40
December	733,88	330,34	133,52	1,06,422	43,53	75,04	31,74	118,57	431,73	22,68	454,41
Jan. 1947	732,99	334,44	133,55	1,067,43	42,81	74,13	30,79	116,94	454,04	23,73	477,77
February	712,37	345,22	133,54	1,057,59	40,00	70,97	28,45	110,97	466,06	23,70	489,76
March	690,49	346,86	133,04	1.037,35	39,04	69 39	27,93	108,43	465,86	22,07	487,93
April	680,69	348,53	134,19	1,029,22	39,35	89,53	48,53	128,88	453,13	20,11	473.24
May	667,77	349,51	136,81	1,017,28	37,98	100,84	60,46	138,82	432·51	16,49	449,00
June	669,94	348,59	137,25	1,018,53	39,73	102,08	61,61	141,81	416,81	14,85	431 66
July	673,71	342,93	138,14	1,016,64	40,29	93,86	53,32	134,15	411,57	16 18	427,75
August	686,27	343,16	140,64	1,029,34	40,98	107,28	66,10	148,26	409,11	16,35	425,46

TABLE 11—MONEY RATE IN INDIA FROM SEPTEMBER 1945 TO AUGUST 1947

(Source: Report on Currency and Finance: Reserve Bank of India).

Month & Year	Call Money Rates		Bazaar Bill Rates*		Average Treasury Bill rate per cent. per annum	Deposit Rates §		
	Calcutta	Bombay	Calcutta	Bombay		3 months	6 months	12 months
(1st of)								
Sept. 1945	½	¼	6 to 7	4½	0·36	½	¾ to 1	1¼ to 1½
October	½	¼	6 to 7	4½	0·33	½	¾ to 1	1¼ to 1½
November	½	¼	6 to 7	5¼	0·34	½	¾ to 1	1¼ to 1½
December	½	¼	6 to 7	5¼	0·44	½	¾ to 1	1¼ to 1½
January 1946	½	¼	6 to 7	5¼	0·44	¾ to 1	1 to 1¼	1½ to 1¾
February	½	¼ to ½	6 to 7	5¼	0·45	¾ to 1	1 to 1¼	1½ to 1¾
March	½	¼ to 1	6 to 7	5¼	0·49	¾ to 1	1 to 1¼	1½ to 1¾
April	½	½	6 to 7	5¼	...	¾ to 1	1 to 1¼	1¼ to 1¾
May	½	½	6 to 7	5¼	...	¾ to 1	1 to 1¼	1¼ to 1¾
June	½	½	6 to 7	5¼	0·38	¾ to 1	1 to 1¼	1¼ to 1¾
July	½	½	6 to 7	5¼	0·39	¾ to 1	1 to 1¼	1½ to 1¾
August	½	¼ to ½	6 to 7	5¼	0·44	½ to ¾	¾ to 1	1½ to 1¾
September	½	½ to ¾	6 to 7	5¼	0·44	½ to ¾	¾ to 1	1½ to 1¾
October	½	½ to ¾	6 to 7	5¼	0·43	¾	¾ to 1	1½ to 1¾
November	½	½ to ¾	6 to 7	6	0·43	¾	¾ to 1	1½ to 1¾
December	½	½	9 to 10	6	0·44	¾ to 1	1 to 1¼	1½ to 1¾
January 1947	½	½	9 to 10	7½	0·44	¾ to 1	1 to 1½	1½ to 1¾
February	½	½	9 to 10	7½	0·44	¾ to 1¼	1¼ to 1½	1½ to 1¾
March	½	½	9 to 10	7½	0·44	1 to 1¼	1¼ to 1½	1½ to 1¾
April	½	½	9 to 10	7½	0·43	¾ to 1	1 to 1½	1½ to 1¾
May	½	½	9 to 10	7½	0·43	¾ to 1	1 to 1½	1½ to 1¾
June	½	½	9 to 10	7½	0·42	¾ to 1	1 to 1½	1½ to 1¾
July	½	½	9 to 10	7½	0·44	¾ to 1	1 to 1½	1½ to 1¾
August	½	½	9 to 10	7½	...	¾ to 1	1 to 1½	1½ to 1¾

* Rates at which bills of small traders are reported to have been discounted by shroffs. These are unofficial quotations.

§ As quoted by the larger Banks in Bombay.

was continuous throughout the period. They recorded a small decline during the subsequent months and stood at Rs. 343·16 crores in August 1947. The excess of balances of scheduled banks with the Reserve Bank over the statutory minimum showed a tendency to decline during the period. Total advances and bills discounted increased almost continuously from Rs. 262·92 crores in October 1945 to Rs. 489·76 crores in February 1947 only with occasional recessions and then declined to Rs. 425·46 in August 1947. The percentage of total advances and bills discounted to total demand and time liabilities of scheduled banks was around 30·32 at the end of the war and subsequent months. But this gradually increased and was around 44·45 in the first three months of 1947. It declined slightly thereafter and was around 42 per cent. in subsequent months. The ratio of clearings to demand liabilities remained steady at 9·3 during 1945–46 and 1946–47 as compared to 9 in 1944–45.

§ 12. *Money Rates*.—Table 11 gives the money rates in India during September 1945—August 1947. The money rates display the usual seasonal hardening but it is interesting to note that their general level moved up somewhat during the period. This is marked in the Bazar Bill rates, but is also observable in the Treasury Bill rates and the rates on deposits for 3 and 6 months. This would generally indicate a slight tightening of money conditions during the period.

The decline in the balances of the scheduled banks with the Reserve Bank, the rise in total advances of scheduled banks and the slight hardening of money rates together indicate a general rise in the demand for money to spend. The slightly increased ratio of bank clearings to bank deposits also indicates the same thing.

§ 13. *Demonetisation Ordinances*.—The Government of India, on 12 January 1946, promulgated two Ordinances, the Bank Notes (Declaration of Holdings) Ordinance 1946 and the High Denomination Bank Notes (Demonetisation) Ordinance 1946. Under the former all banks in India were required to furnish to the Reserve Bank, up to 3 p.m. on that day, a statement of their holdings of notes of Rs. 100, Rs. 500 Rs. 1,000 and Rs. 10,000 as at the close of business on 11 January 1946. Holders of such notes were allowed to get them exchanged at the Reserve Bank of India, a scheduled bank or a government treasury after giving a declaration on the prescribed form, within 15 days of the commencement of the Ordinance. Thereafter the Governor and the Deputy Governor of the Reserve Bank were allowed to exchange such notes up to 26 April 1946. Thereafter the Government of India exchanged the notes of bona fide holders up to 28 February 1947. It was announced that no further claims were to be considered in that connexion after 28 February 1947.

The bulk of the outstanding notes of the denominations affected by the Demonetisation Ordinance were cashed by 26 January 1946. The total amount of notes of these denominations outstanding on 31 December 1947 was Rs. 3 lakhs in the case of Rs. 500 denomination, Rs. 1·12 lakhs of Rs. 1,000 denomination and Rs. 21 lakhs of Rs. 10,000 denomination as against Rs. 26 lakhs, Rs. 113,37 lakhs and Rs. 1,846 lakhs respectively on 31 December 1945[13].

On the whole the Demonetisation Ordinances were more dramatic than economically effective. The joint statement of Indian economists referred to earlier observed in this connexion: "The Demonetisation Ordinances cannot bear any important consequences as long as currency continues to be issued in large amounts, week by week. It cannot check either speculative pressure on prices or the operation of blackmarketers. The Ordinances do not directly reduce the volume of currency, they merely change the form in which it is held. They will put those notes of high denomination out of circulation the holders of which do not present them for exchange within the specified time limit. The declarations made by holders of high denomination notes will lead to an increase in the receipts from taxation of incomes and profits and this might also have some deflationary effect. The total result in this direction cannot, however, be expected to be large in relation to the total value of notes in circulation. On the other hand, the ordinances might lead to making active, monetary hoards which were previously dormant. The Ordinances may result in visiting some malefactors with loss or taxation, but they cannot be taken to indicate even a beginning with the tackling of the real problems that lie ahead." That the expectations of the economists fully came true cannot be gainsaid in the light of statistics quoted above.

§ 14. *Delinking of the Rupee.*—At the end of 1946 India became an original member of the International Monetary Fund and the International Bank of Reconstruction and Development. The par value of the rupee that was communicated to the Fund was the same as before, being the gold equivalent of 1 s. 6 d. As a member currency of the Fund the rupee became independent of the sterling and the Reserve Bank of India Act was accordingly amended in April 1947. "The amendment repealed Sections 40 and 41 of the Reserve Bank of India Act which had obliged the Bank to buy and sell sterling without limit between certain specified rates above and below 1 s. 6 d. per rupee and replaced them by a section which requires the Reserve Bank to buy and sell foreign exchange at such rates and on such terms and conditions as the Central Government may determine from time to time in conformity with their obligations

13 *Report on Currency and Finance* 1947-48, Reserve Bank of India, p. 120.

as a member of the Fund."[14] While moving for a consideration of the bill for the above amendment in the Reserve Bank of India Act in the Legislative Assembly the Finance Member observed: "This Bill will break the statutory link between the rupee and sterling but, by virtue of the notification which it is proposed to issue under the new Section 40, it will not have the immediate effect either of changing the rupee sterling exchange rate or of taking India out of the sterling area."[15]

§ 15 *Employment and wages.*—Table 12 gives figures regarding the total employment in factories in India in 1945, 1946 and 1947 in different Provinces in India and the average annual earnings of employees in factories during the same period.

TABLE 12—AVERAGE DAILY NUMBER OF WORKERS EMPLOYED IN FACTORIES AND THE AVERAGE ANNUAL EARNINGS OF EMPLOYEES* IN FACTORIES

(Source: Indian Labour Gazette).

Province	Workers employed			Earnings in Rs.		
	1945	1946	1947	1945	1946	1947
(1) Ajmer-Merwara	15,877	15,789	15,864	419 8	447 8	438·4
(2) Assam	58 070	60,487	56,119	660 5	687 5	746·7
(3) W. Bengal	7,02,964 §	6,63,087 §	667,626	465·5	496 3	...
(4) Bihar	1,68,408	1,38,990	136,834	538 7	544 0	819·8
(5) Bombay	7,35,774	6,83,517	697,895	814 7	812 3	977·9
(6) C. P. & Berar	1,10,263	1,01,355	97,219	530 6	479 7	529·6
(7) Coorg	27	53	117	...	...	...
(8) Delhi	36,870	33,349	31,320	699 9	837 2	877·7
(9) Madras	2,79,176	2,62,292	276,586	357 6	422 2	560 3
(10) Orissa	7,427	7,413	10,592	417 2	440 1	493·6
(11) E. Punjab	44,759 §	...	...	...	...	...
(12) United Province	2,76,468	2,57,140	240,396	551 7	593 6	672·8
Total ...	2,436,083	22,23,502	22,30,568	...	...	...

* Covers employees drawing below Rs. 200/- per month.

§ Estimated.

14 *Report on Currency and Finance*, Reserve Bank of India, 1946-47, p. 61.

15 *Indian Information*, 1 May 1947, p. 414.

The total average employment in factories declined by about 9 per cent. during 1946 over that in 1945. In 1947 there was a slight rise in the total employment. As compared to 1945 the employment in all the provinces, except Coorg and Orissa, recorded a decline during 1947. As compared to 1946, however, employment showed an increase in Ajmer-Merwara, West Bengal, Bombay, Coorg, Madras and Orissa. Average annual earnings of factory employees in 1947, on an average showed a rise of about 24 per cent. over those in 1945. The highest increases in 1947 over those in 1945 amounted to over Rs. 281 in Bihar, Rs. 203 in Madras, Rs. 177 in Delhi and Rs. 163 in Bombay. The average level of earnings had only slightly gone up during 1946 and the larger part of this increase had occurred in 1947.

§ 16 *Capital Issues.*—The statistical data relating to the working of the control of Capital Issues from 1 October 1945 to 31 March 1947 shows that while during the war, during a period of 28½ months the total capital issues sanctioned were worth Rs. 260·56 crores, in the 18 months of the post-war period sanction was given to issues worth Rs. 379·96 crores. This liberalization in respect of the amount sanctioned can be also seen from the fact that the average amount of capital sanctioned in respect of a company during the war period was Rs. 6·9 lakhs but it was Rs. 32·1 lakhs during the 18 post-war months. The latter average may be partly the result of the exemption granted to issues not exceeding Rs. 5 lakhs.

Control over capital issues secured under the Defence of India Rules and continued later by Ordinance, was enacted into law through the Capital Issues (Continuance of Control) Bill on 19 April 1947. The Select Committee to which the bill was referred made certain modifications which were adopted. The important changes were: (i) Period of the duration of control to be 3 instead of 5 years, (ii) Right to ask for reasons of refusal granted to applicants, (iii) Appointment of an advisory committee to advise the Government on the administration of the Act.

§ 17 *Central Government Budget, 1946–47.*—The Budget Estimates for 1946–47 put the total revenue receipts at Rs. 307·0 crores and the total expenditure at Rs. 355·71 crores, leaving a prospective revenue deficit of Rs. 48·71 crores. Many concessions were made to taxpayers in the budget. The chief among these were: (i) Complete abolition of the Excess Profits Tax after 31 March 1946. (ii) The grant of special initial depreciation allowances of 10 per cent. on new buildings and 20 per cent. on new buildings and machinery and other allowance for purposes of income tax. (iii) Net reduction of 1¾ annas in the total rate of super tax and income tax payable by a company. (iv) By various concessions differential treatment in favour of earned incomes for income tax purposes. (v) Reduction of duty on kerosene oil and motor spirit,

The new taxation measures included among others: (i) Increase in the rate of income tax on the balance of income above Rs. 15,000 from 4 annas 9 pies to 5 annas. (ii) Additional super tax at steepening rates on dividends (other than dividens payable at fixed rates) in excess of 5 per cent. of the capital of a company (other than a private company) including reserves or 30 per cent. of the total income, whichever is higher. (iii) An increase in the duty on imported betel-nuts to a standard rate of 5½ annas per pound (without surcharge) with a preference of 6 pies per pound for British Colonies.

As a result of tax concessions, the total deficit on revenue account, after new taxation, increased to Rs. 70·16 crores. By transferring to revenue Rs. 26·10 crores, the estimated balances in the two War Risk Insurance Funds, this deficit was reduced to Rs. 44·06 crores.

A separate capital budget, distinct from the revenue budget, was presented for the first time in 1946–47, to "focus attention", in the words of the Finance Member, "on the productive and deadweight indebtedness of Government, and on the expenditure of loan monies on productive and unproductive schemes". The total receipts under capital account for the year 1946–47 were put at Rs. 305·24 crores, including new loans of Rs. 250 crores. The total expenditure on capital account was put at Rs. 173·18 crores, leaving a surplus of Rs. 132·06 crores. On the expenditure side the two largest items were the expenditure of Rs. 52·50 crores for grants, loans and advances to Provincial Governments for development purposes and of Rs. 65 crores for the repayment of Defence Bonds 1946, maturing in August 1946.

The 1946–47 budget proposals were wholly inspired by the desire to combat the deflationary tendencies which were expected to manifest themselves in some strength as a result of the fall in war expenditure. Introducing the budget, Sir Archibald Rowlands, the Finance Member, said: "In one important respect, however, the situation in India resulting from the cessation of hostilities differs from that in other important belligerent countries such as the United States of America. In largely agricultural countries such as India and the Middle Eastern States, war expenditure though in absolute amounts much less than in the industrialised states of the West had had a proportionately greater effect in stimulating the growth of the national income. It follows, that with the fall in war expenditure which is now inevitable, a greater proportionate effort will have to be made if the national income is not to fall too far below its war-level. In other words, deflationary tendecies will, in the event of counteravailing measures, begin to manifest themselves before very long. It must therefore be the object of the Government, in the coming year, with the help of the public and the business community, to avoid the Schylla of increasing inflation and the Charibdis of too precipitate a deflation."

§ 18. *Budget for 1947-48.*—The Revised Estimates for 1946–47 showed increases both under receipts and expenditure on revenue account leaving a revenue deficit of Rs. 45·28 crores. The Budget Estimates for 1947–48 put the total revenue, at the then existing level of taxation, at Rs. 279·42 crores and the expenditure charged to revenue at Rs. 327·88 crores, leaving a prospective gap of Rs. 48·46 crores. (excluding expenditure involved in implementing the recommendations of the Central Pay Commission). Two concessions were made to the tax payers: (1) Abolition of salt duty, and (ii) raising of the minimum exemption limit in respect of tax on incomes from Rs. 2,000 to Rs. 2,500. As a result the prospective deficit increased to Rs. 56·96 crores. Of this about Rs. 40 crores were to be met by additional taxation. The new measures of taxation among others were: (i) Special income tax of 25 per cent, later reduced to 16½ per cent, on business profits exceeding Rs. 1 lakh. (ii) A graduated tax on capital gains exceeding Rs. 5,000, later raised to Rs. 15,000, made from the disposal of capital assets in recent years. (iii) Doubling of the export duty on tea and the rate of Corporation Tax. (iv) A change in the scale of the super tax.

The Capital Budget, 1947–48, showed that according to the Revised Estimates for 1946–47, instead of the budgetted surplus of Rs. 132·06 crores there was a deficit of Rs 61·52 crores. This was mainly because the new loans during the year came upto only Rs. 111·59 crores, as against the budgetted Rs. 250 crores. In the Revised Estimates there was an item under receipts not provided for in the original budget. This was receipts under "Special Floating Loans". It was a special issue of non-negotiable non-interest bearing securities for paying a part of the subscription to the International Monetary Fund and for the purchase of quota shares in the International Bank of Reconstruction and Development. "Credit is taken for these issues by *per contra* debit under currency capital outlay. As the securities are cashed by the Fund or Bank the debit will be taken under Debt."[16] The Capital Budget for 1947–48 put receipts at Rs. 220·01 crores, Rs. 150 crores of which were to be raised by new borrowings, and disbursements at Rs. 218·35 crores, leaving a prospective surplus of Rs. 1·66 crores. The budget provided for grants totalling Rs. 45 crores to Provinces for development and also loans to them of Rs. 32 crores for productive schemes.

Introducing the budget the Finance Member, Mr. Liaquat Ali Khan, noted that the transition from war to peace economy in India had been slow and halting; that the deflationary tendencies that were expected to manifest themselves soon after the end of the war, had not happily made their appearance and inflationary trends had continued to persist and

16. *Explanatory Memoranda* 1947–48 Budget, p. 30.

prices had been running high. He further stated that his budget proposals were not related to purely financial purposes but to certain social objectives. He declared "India is a land of glaring contrasts and disparities.........The conditions created by the last war served to accentuate these disparities: the rich became richer and the poor, poorer. This meant the concentration of wealth in fewer and fewer hands and, inevitably, the use of that wealth for the purpose of tightening the strangle-hold of Big Money over the economic life of the country as a whole by the acquisition of business, companies, public utilities, and the press. A set of conditions in which the few are able to wield such vast power over the many can hardly be regarded as anything but a negation of the principles of social justice... It is against this background that my budget proposals have been formulated (as) the first stage of a policy of social justice and development which it will require years to bring to full fruition" The Finance Member was much more correct, than perhaps he himself realised at the time he made the statement, about the stranglehold of Big Money on the economic and political life of India; for his budget, egalitarian in tone and content, stirred a veritable hornets' nest and Big Money was able to tone down considerably a good many of his sound proposals through their hold on the rival political party in the then coaliation cabinet.

§ 19. *Government Borrowing.*—The total subscriptions to Government of India loans during 1945–46 amounted to Rs. 376 crores as compared with Rs. 112 crores during 1946–47. During the two years the Government pursued a cheap money policy and "continued to float loans on progressively more favourable terms either by a reduction in the rate of interest on loans or by an increase in their maturity, which meant a lowering of the effective rate of Interest." [17]

The 3 per cent. Second Victory Loan 1959–61 issued on 19 March 1945 was closed on 15 December 1945, the total subscription amounting to Rs. 113·74 crores. The 3 per cent. First Development Loan, 1970–75, a cash-cum-conversion loan, was issued on 9 April 1945, subscription being in cash or 5 per cent. (tax free) Loan 1945–55 which was to be repaid on the 15 October 1945. Government, subsequently, created three special issues of this loan, the aggregate face value of the loan totalling Rs. 115·06 crores when it closed on 16 March 1946.

On 19 April 1945 was created a further issue of Rs. 25 crores of the 2¾ per cent. Loan 1948–52, the tap being closed on 18 September 1945. On 9 July 1945 2½ per cent. Bonds 1950 were issued, and the total subscriptions including those to the special issue of the same loan, came to Rs. 35 crores when it closed on 16 February 1946. On 29 September 1945 a further issue of Rs. 25 crores of the 3 per cent. Loan 1963–65 was

17. *Report on Currency and Finance*, Reserve Bank of India, 1945–46, p. 68.

created and on 8 January 1946 a further issue of Rs. 25 crores of the 2¾ per cent. 1960 Loan was announced. Yet another fresh issue of Rs. 20 crores of this loan was created on 9 April 1946 The Five Year Interest Free Prize Bonds 1949 were discontinued in December 1945, their total sales upto that time amounting to Rs. 5·30 crores. On 22 July the 2½ per cent. 1961 Loan for the approximate amount of Rs. 35 crores was put on the market and a special issue of Rs. 20 crores of the same loan was created on 5 August 1946. On 8 November 1946 the 2¼ per cent. 1954 Loan for Rs. 35 crores was announced. The Three Years Interest Free Defence Bonds, first issued in 1940, were closed on 14 May 1946.

The 5 per cent. (Tax Free) Loan 1945–55 fell due for repayment on 15 October 1945 as per the notice of redemption given by Government. Of the outstanding balance of Rs. 56·75 crores Rs. 18·92 crores were tendered for conversion into the 3 per cent. First Development Loan 1970–75 and the total amount repaid upto 31 March 1946 came to Rs. 24·48 crores. Of the outstanding balance of Rs 65·14 crores of the 3 per cent. Six Year Defence Bonds 1946, Rs. 63·38 crores were repaid upto 31 March 1947.

An outstanding financial event of the year 1946–47 was the conversion of the 3½ per cent. non-terminable loans into the 3 per cent. Loan 1986 or the 2¾ per cent. Loan 1976. Of the total outstanding balance of Rs. 272·90 crores on 31 May 1946 of the 3½ non-terminable Loans, Rs. 246·84 crores and Rs. 14·59 crores were tendered respectively for conversion into the two loans referred to above upto 14 October 1946, the last date for conversion. Of the remaining the value of securities surrendered for repayment upto 31 March 1947 came to Rs. 3·52 crores. As a result of this conversion operation, the saving in interest charges to the Government of India was estimated at about Rs. 1·35 crores. The Governor of the Reserve Bank of India has since revealed that the Reserve Bank had opposed this operation as likely to aggravate inflation and that the conversion operation had considerably disturbed money market conditions.[18]

During the war because of the exceedingly easy money conditions in the money market the Government of India was able to borrow in the open market at progressively cheaper rates of interest. "By the beginning of 1946 the yield on non-terminable loans had been reduced from a little short of 3·75 per cent. to round 3·25 per cent. and the yield on long-dated Government Securities had been brought down from 3·15 per cent. to a little under 3 per cent."[19] A more determined attempt to cheapen money rates was made by Government from the

18. Sir Chintaman D. Deshmukh, *Central Banking in India—A Retrospect*, 1948, p. 26, Kale Memorial Lecture, G. I. P. E.

19. Deshmukh, op. cit, p. 24.

beginning of 1946 and the climax was reached when the non-terminable $3\frac{1}{2}$ per cent. Paper was converted into dated loans carrying smaller rates of interest as noted above. This vigorous pursuit of cheap money policy at a time when there was limited scope for an increase in production and when the whole structure of controls was coming unstuck because of wavering government policy, resulted only in aggravating inflation.

§ 20. *Food Situation.*—During 1945-46 the food situation in the country deteriorated because of the failure of rains over wide areas of the country, particularly in Peninsular India. The total production of the four main cereals, rice, wheat, jowar and bajri was only 464 lakh tons in 1945–46 as compared with the average for the previous five years of 509 lakh tons. The internal procurement in 1946 realised 50·5 lakh tons as compared with 45·5 lakh tons in 1945 though in the meanwhile the rationed population had exactly doubled. As a result of the threatened famine and inadequate and slack procurement in surplus provinces like the Punjab and Sind the deficit of food grains for the year 1946 was estimated at between forty and sixty lakh tons. The Government of India tackled the situation by making efforts to import a larger quantity of foodgrains from abroad than before and also by cutting down internal consumption and waste, tightening procurement machinery and extending rationing. From the middle of February 1946 the daily *per capita* basic cereal ration of foodgrains was reduced from 16 oz. to 12 oz. Future and option contracts in wheat and gram were banned. Foodgrain exports were completely stopped and export of oilseeds, edible oils and fats was reduced to a minimum. The total imports of foodgrains that India could secure from abroad, during 1946, amounted to 21·7 lakh tons. As against 52 million persons under direct or indirect rationing in 1945, the number in 1946 was 100 million, increasing to 171 million on the eve of Independence. During 1946–47 the harvests were again bad and wheat crop was damaged by rust. The production of the four main cereals, during the year, was only slightly higher than during the previous year being only 468 lakh tons. The total internal procurement of food grains upto September 1947, was 41·7 lakh tons. The total imports of foodgrains from abroad during the year upto September 1947 were 20·1 lakh tons. As a result of this worsening situation even the reduced 12 oz. ration could not be maintained during 1947 and in many regions, such as Cochin, Travancore, Madras, Delhi, Ajmer, etc. it had to be reduced to 8 oz. or even less.

§ 21. *Economic policy.*—During the two years following the end of World War II the economic policy of the Government of India was so drifting, opportunistic and inconsistent that it can hardly be described as "policy". The shifting political scene in the country was partly responsible for this; for during this short period there were no less than five Finance Members. No well-knit policy regarding the problems of transi-

tion from war to peace economy could be expected in these circumstances and as a consequence these problems were misconceived, misjudged and mishandled. Sir Archibald Rowlands set the ball rolling by framing a budget with the ostensible aim of combating deflationary forces that were *likely* to arise, but actually on the hypothesis that the threatened deflation *had already* arrived. The intensification of the cheap money drive was of the same piece. The other incumbents of the finance portfolio were there for too short a period to frame any overall policy and usually contented themselves by carrying on somehow. Mr. Liaquat Ali Khan appeared to have grasped the problem and to have taken the first step towards the framing of a clearcut economic policy but before he could take any effective steps his term of office came to a sudden end by the partition of the country.

Government policy in regard to economic controls was particularly undecided and the confusion that resulted is borne ample testimony to by the remarks about the working of controls in the various reports of the Commodity Prices Board [20] as well as by the action taken by Government on their recommendations. It is not possible to give all the measures taken by Government during these two years. Only some more important measures are noted here. They serve to show the broad characteristics of Government economic policy. In December 1945 the Timber Control Order of 1945 was withdrawn. In January 1946 the Government removed from the schedule to the Consumers Goods (Control of Distribution) Order 1943, all items excepting pure and artificial silk yarn, umbrellas, hurricane lanterns, cycles and cycle parts and lead, copying and coloured pencils. Prices and distribution of silk and artificial silk and yarns and fabrics were decontrolled on 17 August 1946.

" With the expiry of the Defence of India Act on 30 September 1946 the Government allowed a majority of wartime measures to lapse excepting certain essential general controls, such as those over capital issues, imports, exports and foreign exchanges and some over the production, supply and distribution of certain essential commodities." [21] The latter were the following :—foodstuffs, edible oilseeds and oil, cotton and woollen textiles, paper including newsprint, petroleum and petroleum products, spare parts of mechanically propelled vehicles, coal, iron and steel and mica. The Hoarding and Profiteering Ordinance terminated on 30 September 1946. Control of prices and distribution reverted to the Provinces from 1 October 1946. Control over the external prices of jute was continued by a special ordinance by the Central Government.

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20. Cf. *Reports of the Commodity Prices Board*, Ed. N. V. Sovani, Gokhale Institute of Politics and Economics, Publication No. 20, 1948.

21. *Report on Currency and Finance*, Reserve Bank of India, 1946-47, p. 42.

But even that was removed from 23 October 1946. The control over the prices and distribution of oil seeds was lifted in March 1947.

In November 1945 the Export Control Notification was revised to allow free exports of over a hundred commodities including chemicals, and chemical preparations, raw cotton, hides and skins, iron ore, scientific instruments of indigenous origin and animal oils. In December 1945 the Control of Imported Engineering Stores Order 1943 was relaxed and metal cutting tools, hand tools, and workshop measuring tools were removed from its purview. By a notification of 22 January 1946 a number of imports were decontrolled. In April 1946 the list of articles covered by the Open General Licence System (introduced in March 1945) was further extended by the inclusion of certain kinds of machinery and again in September, of a further hundred categories of articles. Some restrictions on imports for conserving foreign exchange and checking non-essential imports were reimposed in March 1947 by the cancellation of the Universal Open General Licence No. VIII. In May 1947 Open General Licences Nos. I and III were abolished. This tightening of import controls was, however, much softened by the liberal policy followed in the revalidation of licences. A new import policy for the shipping period July-December was announced on 3 July 1947 under which imports were classified into free, restricted and prohibited.

§ 22. *Production.*—Table 13 gives the available data regarding the acreage and yield of principal crops in India during 1944–47. The production of the main cereals was at a very low level during 1945–46 and 1946–47 and the same was the case with oil seeds. Cotton production showed a slight decline over the period. Jute production was very much higher in 1945–46, about 29 per cent. larger than that of the previous year. But it fell equally sharply during the subsequent year being 10 per cent. lower than that of 1944–45. Figures regarding 1947–48 are not available but according to the revised estimates of the yield of seven major foodgrains of the country in that year the production was 40,425,000 tons as compared with 39,528,000 tons in 1946–47. This was in spite of the loss of 1,200,000 tons in the crop production of Madras due to the failure of the monsoon.[22]

Table 14 gives figures regarding industrial production in India. The figures for 1947–48 are totals of industrial production in undivided India upto 15 August 1947 and that in the Indian Union only from that date to 31 March 1948. As the majority of the industrial establishments are located in India, these totals might be taken to represent broadly the industrial production in the Indian Union during the whole year. There was a pronounced decline in cotton piecegoods during the period. The

22. *Indian Information*, June 1948.

fall in production was particularly sharp during 1946–47, when production was 16 per cent. lower than during the previous year. While cement production showed a small increase over the previous year during 1945–46, it recorded a sharp fall of about 20 per cent. during 1947–48 over that of 1946–47. Paper production showed a rising trend upto 1946–47 but

TABLE 13—AGRICULTURAL PRODUCTION IN INDIA DURING 1944–47
(Source : Reserve Bank of India Bulletins).

Crop	Forecast[1]	Area (000 acres)			Yield			
		1944–45	1945–46	1946–47	Unit	1944–45	1945-46	1946-47
1	2	3	4	5	6	7	8	9
Rice	Final	83,933	79,885	81,810	000 Tons	28,183	26,672	28,141
Wheat	,,	35,709	34,977	34,121	,,	10,458	9,038	7,788
Jowar	First	...	39,154	24,543	,,	...	5,523	...
Bajra	,,	...	25,044	22,241	,,	...	3,374	...
Maize	,,	...	8,712	8,297	,,	..	2,518	...
Sugarcane	second	4,154	3,825	4,108	,,	5,481	5,387	...
Groundnut	,,	10,571	10,273	9,990	,,	3,856	3,466	3,492
Sesamum	Final	3,939	3,936	3,795	,,	393	387	324
Rape and Mustard	,,	5,580	5,535	5,518	,,	1,034	919	1,002
Linseed	,,	3,465	3,334	3,288	,,	392	369	349
Castorseed	...	...	1,431	1,346	,,	...	123	121
Cotton	second	14,803	14,478	14,608	000 Bales	3,543	3,438	3,388
Jute	Final	2,104	2,422	1,880	,,	6,203	7,991	5,552
Tea*	...	...	...	...	Millions lbs	407·56	434·71	484·12

1 This relates to columns 5 and 9 only.

* Production in Northern India only.

production in 1947–48 was below even the 1944–45 level. Sugar showed a continuously declining trend. Matches, finished steel and steel ingots showed substantial increases in 1945–46 over that of the preceding year but have since showed a downward trend. Broadly speaking the production of jute manufactures continued at a higher level along with sulphuric acid and sulphate of ammonia. Pig iron showed a large increase during 1947–48. The production of coal and electrical energy remained fairly stable during the period

TABLE 14—INDUSTRIAL PRODUCTION IN INDIA DURING 1944-48.

(Source : Monthly Survey of Business Conditions in India).

	Commodity	Unit	1944-45	1945-46	1946-47	1947-48 (Provisional)
1	Cotton piece goods	Million Yds.	4,726·4	4,651·3	3,863·3	3,734·7
2	Jute Manufactures (including Twist and Yarn)	(000) Tons	975 02	973·44	1,041·93	1,027·51
3	Cement	(000) Tons	2,043·5	2,145·8	2,027·2	1.634·0
4	Sulphuric Acid	(000) Cwts.	455 92	480·49	596 90	587·83
5	Sulphate of Ammonia	Tons	22,405 0	21,101·0	21,312·0	21,510 0
6	Paper	(000) Cwts.	1,472·32	1,681·24	2,318 8	1,415·0
7	Sugar	(000) Cwts.	21,127 0	17,639·0	16,798·9	11,71·1[2]
8	Matches	Million Gross	17·10	20·21	18·72	16·84[3]
9	Pig Iron	(000) Tons	1,400·35	1,406·19	1,327 74	1,522·70
10	Steel Ingots	(000) Tons	1,253·90	1,299·73	1,212·00	1,210·40
11	Finished Steel (Including Semis[1])	(000) Tons	1,268·02	1,338·11	1,199·69	1,137·91
12	Electrical Energy Generated (British India only)	Million Units	3,425·6	3,576·0	3,474·5	2,636·5[4]
13	Coal	(000) Tons	24,154	26,543	26,218	26,769

1 Excluding Blooms, Billets and slabs.

2 Total for 7 months ending October 1947 only.

3 Total for 11 months ending February 1948 only.

4 Figures for Indian Dominion from 15th August 1947 to 31st March 1948. The total from 1st April 1947 to 14th August 1947 is 14:3-3.

III. DEVELOPMENTS AND ECONOMIC POLICY AFTER 15 AUGUST 1947

§ 23. *Some economic consequences of Partition.*:—The partition of India on 15 August 1947 involved a division of resources and peoples and had some far-reaching economic consequences. The data for indicating these are as yet very meagre. Some consequences of partition, so far as they could be judged from such data as are available, are indicated below.

The total area of Pakistan is about 71 million square miles and the total population a little over 70 million. By partition India lost a little less than 20 per cent. of her land and 23 per cent. of her population. Very broadly speaking most of the large scale industries in undivided India are situated in the Indian Union. Pakistan has 16 cotton mills, 9 sugar mills, 5 cement factories and 4 glass factories but no jute or paper mills or iron and steel works. Pakistan has no mineral resources besides chromite, gypsum and petroleum. Her share in the total mineral production in India during 1945 was 3·2 per cent.

But Pakistan is rich in agricultural resources and the partition has adversely affected the Indian Union primarily in this sphere. Nearly one-third of the total irrigated area in pre-partition India, is now in Pakistan. Pakistan, on an average, produced about one-third of the total rice and wheat produced in pre-partition India. Relatively to her population therefore, the position of India has definitely become worse in respect of rice and wheat than before the partition. The food shortage in India as a result of partition may be considered to have increased by anything between 7–8 lakh tons of foodgrains. In respect of oil seeds the position of the Indian Union is strong because Pakistan produces only a small proportion of the total oil seeds produced in pre-partition India. In the production of rape and mustard Pakistan's share is significant, being about 20 per cent.

The raw cotton position of the Indian Union has been adversely affected by partition. The share of Pakistan in the total cotton production in India was about one-third; it was as high as about 60 per cent. in the production of long and medium staple varieties.[23] Almost the whole of the cotton textile industry is located in the Indian Union and during 1945–46 it consumed 3·1 million bales of cotton. Of these 1·2 million bales were of long and medium staple varieties. During the same year the total cotton production in the Indian Union amounted,

23. *Indian Trade Bulletin*, 1947 Annual Review Number, Ministry of Commerce, p. 51.

according to trade estimates, to 2·47 million bales of which 1·3 million bales were of long and medium staple cotton.

It is obvious that as a result of the partition the Indian Union has become a net importer of raw cotton. The average annual raw cotton requirements of the Indian Union can be reasonably put at about 3·5 million bales even if the total capacity of the Indian textile industry remains the same. The Indian Union will have to import cotton from Pakistan or abroad and most of it will have to be of medium and long staple varieties.[24] The present exportable surplus of raw cotton of the Indian Union has been estimated at between 100,000 and 200,000 bales of short staple cotton by the Indian delegation to the International Cotton Advisory Committee.[25] Even if raw cotton production in the Indian Union increases by 50 per cent. over the present level, the Indian Union will not be in a position to export a significantly larger quantity. The development of the cotton textile industry in Pakistan is only a matter of time and when developed it will be a strong rival to the Indian textile industry. Much of the talk about India taking the place of Japan in textile exports has now to be considerably modified.

The jute situation of the Indian Union has also been very adversely affected by the partition. On an average 75 per cent. of the total jute produced in India is grown in the Pakistan areas. If only the export varieties are considered Pakistan's share comes to 50 per cent.[26] The *Tossa* and *Daisee* varieties of jute grown in the Indian Union are largely exported. The jute manufacturing industry is located almost wholly in the Indian Union. The annual consumption of raw jute during the last ten years has been never less than 5·5 million bales while during the same period the average production of raw jute in the Indian Union was around 1·8 million bales. The Indian Union will have to be a net importer of raw jute on a considerable scale even if production of raw jute is pushed to the farthest point of expansion. As in the case of the cotton textile industry, the development of the jute manufacturing industry in Pakistan is only a matter of time and there can be no doubt that the jute manufacturing industry in the Indian Union will have to play second fiddle to it.

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24. At the 56th meeting of the I. C. C. Committee it was suggested that the Indian Union can become self-sufficient in regard to raw cotton. But there are great difficulties in the way. It is, for instance, imprudent and uneconomic to extend the area under cotton in the Indian Union materially in the face of the increased deficit in food supplies resulting from partition. The only hope lies in increasing per acre yields by intensive agriculture .The latter will depend on the effectiveness of state planning in that regard.

25. *Times of India*, 17th May 1948.

26. *Indian Trade Bulletin*, op. cit.

Because of partition India also lost a part of her market and what was formerly an assured and protected internal market now became a foreign competitive market. Implications of this in respect of such goods as cotton textiles, sugar, etc. can be grasped on a little reflection.

According to the Indo-Pakistan Financial Agreement of December 1947, Pakistan's share of the public debt is made up of the value of assets, physical or financial, which lie in Pakistan or are taken over by the Pakistan Government plus 17½ per cent. of the uncovered debt represented by the excess of liabilities over assets of the undivided central Government, less liability directly assumed by the Pakistan Government. Valuation of assets is to be as per book values, except in the case of railways, where these were to be written down by 50 per cent. The initial responsibility for all the liabilities of the undivided Government at the time of partition has been assumed by the Government of India and Pakistan is to pay her share to India in Indian rupees in 50 annual equated instalments for principal and interest combined commencing from 15th August 1952. According to the Finance Minister, on a rough estimate, Pakistan's share of debt was of the order of Rs. 300 crores and the rate of interest, according to the agreed formula, near about 3 per cent. Pakistan's share of the undivided Government of India's cash balances of a little under Rs. 400 crores, was agreed upon at Rs. 75 crores. Each dominion was to continue to disburse the pensions then in her territory, India continuing to pay the overseas pensions. The value of all pensions, both part earned and in issue, was to be capitalized and the liability to be shared in the same ratio as agreed upon for sharing the uncovered debt.

Under the Pakistan (Monetary System and Reserve Bank) Order as amended in March 1948, the Reserve Bank of India was to continue to be the monetary authority for Pakistan upto 30th June 1948. Pakistan's share of the assets of the Issue Department was to be equal subject to adjustments enumerated in the Order, to the total liability in respect of Pakistan notes outstanding on the 30th June 1948 and India notes which were legal tender in Pakistan on that date or in respect of which the rights of encashment in Pakistan existed on that date and which the Government of Pakistan might accept at par until 30th June, 1949. The various classes of these assets were to be transferred in proportion in which they were held by the Bank on 30th June 1948. Provision for the discharge of the Bank's obligations in the Banking Department in Pakistan and for the division of the Reserve Fund and profits of the Bank was also made under the Order.

§ 24. *Prices.*—Table 15 gives the index numbers of wholesale prices (both old and new series) issued by the Office of the Economic Adviser for each month from August 1947 onwards. The general purposes index rose from 301·4 in August 1947 to 389·6 in July 1948,

showing a rise of about 88 points. The index had fluctuated around 302 upto November 1947 and had then mounted rapidly. The same pattern is discernible in all the other constituent indices, except the index of the prices of the miscellaneous group which declined up to February 1948 and then rose sharply. The index of manufactured articles also had not risen to any marked extent in December 1947. A very similar pattern of price movements during the period is also revealed by the sensitive index and its constituent indices. The highest increase of about 96

TABLE 15—INDEX NUMBERS OF WHOLESALE PRICES IN INDIA DURING AUGUST 1947 TO SEPTEMBER 1948

(Source : Reserve Bank of India Bulletins).

Month and Year	Sensitive Week ended 19th August 1939 = 100					General Purpose Year ended August 1939 = 100					
	Agricultural Commodities	Raw Materials	Primary Commodities	Manufactured Articles	General Index	Food Articles	Industrial Raw Material	Semi-manufactured Articles	Manufactured Articles	Miscellaneous	General Index
Aug. 1947	351·8	241·1	303·7	284·3	299·3	297·8	366·5	258·3	280·2	456 6	301·4
September	346·6	242·6	301·6	285·1	298·0	296·2	371·6	258·1	282·6	457·8	302·4
October	347·0	241·2	302·8	281·9	298·2	295·3	376·6	256·8	283·5	468·2	303·2
November	340·7	247 1	300·7	283·1	296 7	294·8	377 9	252·5	283·2	460·8	302·0
December	363 2	259·9	317·9	289·6	311 6	321·1	394·7	259 9	284·0	454·2	314·2
Jan. 1948	386·4	279 6	340 6	308·5	333·4	347·7	403·9	272 9	292·9	455·7	329·2
February	388·8	291·1	348·7	317·8	341·8	348 5	404·8	293·9	321·3	429·5	342·3
March	402·4	287·4	353·0	311 5	343·6	347·1	397·7	285·8	324·5	448·7	340·7
April	...	...	...	...	...	348 8	414·6	299·8	325·8	478·5	347·9
May	...	...	...	...	...	357 6	442 3	317·9	351·0	504·2	367·2
June	...	...	...	...	...	377 1	451·5	323·4	370·1	520·0	382·2
July	...	...	...	...	...	390·7	449·9	338·2	370·2	537·3	389·6
August	...	...	...	...	...	397·7	438·1	330·7	353·0	532·6	382·9
September	...	...	...	...	...	396·6	435·1	340·2	348·1	531·1	382·3

points from November 1947 to July 1948 was recorded by the index of food prices. The sharp rise in the indices of the prices of food and industrial raw materials can be solely attributed to the removal of controls over their prices, distribution, etc. by the Government of India in December 1947. The rise in the index of the prices of manufactured articles was to be largely attributed to the lifting of controls on cotton

TABLE 16—INDEX NUMBERS OF WHOLESALE PRICES OF AGRICULTURAL COMMODITIES DURING JAN. 1947–SEPT. 1948

(Source—Reserve Bank of India Bulletins)

Commodities	1947												1948											
	January	February	March	April	May	June	July	August	September	October	November	December	January	February	March	April	May	June	July	August	September	October	November	December
1 All Agricultural Commodities	315	325	336	338	334	341	351	352	347	347	341	363	386	389	402	426	446	467§	466§	444§	445§			
2 Rice	319	333	333	333	333	333	333	333	333	333	333	366	378	382	396	396	396	396	413	424	424			
3 Wheat	373	373	373	373	373	573	373	373	373	373	373	373	496	539	516	532	539	580	691	735	781			
4 Groundnut	317	350	442	461	468	474	508	503	492	464	437	470	492	483	467	484	503	513	515	491	489			
5 Linseed	372	397	402	368	372	390	425	429	428	435	412	406	418	393	354	355	383	386	391	379	369			
6 Cotton, Raw	201	196	193	191	191	195	198	195	194	213	212	221	233	248	267	306	330	314	296	254	253			
7 Jute Raw	419	441	433	430	435	439	392	390	412	471	447	458	474	466	470	463	512	520	514	524	535			
8 Tea	164	186	260	269	219	219	215	249	246	237	228	256	245	258	258	253	246	...	247	254	246			
9 Coffee	315	324	322	324	324	331	350	357	344	340	337	338	347	404	622	558	598	610	601	580	555			
10 Sugar	212	212	212	212	212	212	212	212	212	212	212	277	363	355	354	367	373	382	377	374	370			
11 Tobacco	386	370	312	347	343	343	339	338	334	334	339	350	352	324	389	434	458	462	489	468	475			
12 Copra	598	598	598	598	598	682	877	790	682	612	614	643	621	566	479	550	614	620	675	666	689			

§ Provisional.

cloth and yarn and the upward revision of the controlled prices of steel, cement and coal.

The movement of prices under the decontrol regime can be best studied by examining the prices of agricultural commodities. Table 16 gives the index numbers of wholesale prices of individual agricultural commodities. The index of the prices of all agricultural commodities fluctuated within narrow limits between August and November 1947. It began to shoot up from December, recording a rise of 22 points during that month. During the subsequent months it mounted rapidly and in May 1948 it had recorded an increase of 105 points over that in November 1947. The rise in prices, it should be observed, was shared by the prices of all the constituent commodities, except linseed and copra. The price rises were disparate ranging from 18 points in the case of tea to 261 point in the case of coffee. The general picture is one of increas-

TABLE 17—INCREASE OR DECREASE IN NOTES AND RUPEES IN CIRCULATION DURING EACH MONTH FROM AUGUST 1947 TO JUNE 1948.

(Source :—Reserve Bank of India Bulletin)

Lakhs of Rupees

Month and Year	Circulation*			Increase (+) or Decrease (−) in Circulation				Progressive increase or decrease in total Notes issued
				Notes		Rupee Coin		
	Notes	Rupee Coin†	Total 1+2	During the month	Progressive from August 1947	During the month	Progressive from August 1947	
	1	2	3	4	5	6	7	
Aug. 1947	1,180,58	160,62	1,341,19	−13,05	...	−1,93	...	...
Sept. ,,	1,173,59	158,37	1,331,95	−6,99	−20,04	−2,25	−4,18	+2,30
Octo. ,,	1,193,39	153,51	1,346,91	+19,80	− 24	−4,86	−9,04	+4,17
Nov. ,,	1,199,90	156,29	1,356,19	+6,51	+ 6,27	+2,78	−6,26	+5,11
Dec. ,,	1,225,36	154,57	1,379,93	+25,46	+31,73	−1,72	−7,98	+5.53
Jan. 1948	1,262,19	155,58	1,417,76	+36,83	+68,56	+1,01	−6,97	+5,29
Feb. ,,	1,286,81	155,60	1,442,41	+24,62	+93,18	+ 2	−6,95	+27,61
Mar. ,,	1,304,36	155,33	1,459,70	+17,55	+110,73	−27	−7,22	+47,78
Apr. ,,	1,308,97	154,00	1,462,97	+4,61	+115,34	−1,33	−8,55	+54,72
May ,,	1,300,60	153,94	1,454,55	−8,37	+96,97	− 6	−8,61	+56,06
June ,,	1,275,07	153,41	1,428,49	−25,53	+71,44	−53	−9,14	+43,25

† Quaternary and Nickel Rupee coin and Government of India Rupee notes.

* At the end of the period.

ing nearness of various prices as compared to the pattern of prices before decontrol. The relative position of individual prices in respect of one another seemed to be disappearing in the general upsurge of prices after decontrol. It is a general movement upwards in which different prices seem to be losing their relative position in the price structure.

§ 25. *Currency.*—From August 1947 to April 1948 total notes and coins in circulation increased by Rs. 131.02 crores. Of these Rs. 128·39 crores were notes. In the same period the total notes issued increased by Rs. 54.72 crores. Table 17 sets out the information regarding the increase or decrease in notes and rupee coin in circulation during every

TABLE 18. ASSETS OF THE ISSUE AND BANKING DEPARTMENTS OF THE RESERVE BANK OF INDIA FROM AUGUST 1947 TO JUNE 1948

(Source :—Reserve Bank of India Bulletin)

Lakhs of Rupees

Month & Year	Issue Department				Banking Department §						
	Gold coin & Bullion	Sterling Securities	Rupee Coin *	Rupee Securities	Notes & Coin	Balances held Abroad ‡	Loans & advances to Governments	Other Loans & advances	Bills purchased and discounted	Investments	Other assets
August 1947	44,42	1,135,32	31,52	57,84	78,59	388,09	1,22	82	6,27	80,62	4,59
September	44,42	1,135,32	33,62	57,84	91,78	383,89	3	36	2,76	85,77	3,17
October	44,42	1,135,32	35,48	57,84	84,55	388,51	6	49	87	90,59	3,75
November	44,42	1,135,32	36,43	57,84	71,23	388,06	5	39	24	96,49	3,88
December	44,42	1 135,32	36,85	57,84	57,50	386,28	34	5	80	94,52	4,04
January 1948	44,42	1,135,32	36,61	57,84	19,35	373,18	5,07	1	2,72	101,32	4,16
February	44,42	1,135,32	36,42	80,34	10,31	379,33	31	2	3,52	88,29	4,37
March	44,42	1 135,32	36,59	100,34	13,02	388,63	11	2	1,40	73,42	4,39
April	44,42	1,135,32	37,88 (3,47)	110,64	11,71 (1)	411,02	41 (–)	–	7,19	66,49	5,67
May	44,42	1,135,32	38,69 (3,84)	126,84	14,63 (–)	417,81	5 (9)	–	3,89	52,64	5,98
June	44,42	1,135,32	39,25 (3,59)	127,84	20,05 (–)	405,62	1 (3)	2	1,45	53,25	6,48

* Capital and Reserves rupees ten crores.

Note : Pakistan figures are shown within brackets below those for India.

§ Including Government of India one rupee notes from July 1940 for India and Government of Pakistan one rupee notes from April 1948 to June 1948 for Pakistan.

‡ Including cash and short term securities.

month in the period from August 1947 to June 1948. In September 1947 there was a net decrease in notes in circulation but in all the subsequent months there were net additions to it. There was a decline after April and up to the end of June 1948 notes and coins in circulation declined by Rs. 34·48 crores.

Table 18 gives the assets of the Issue and the Banking Departments of the Reserve Bank of India during August 1947—June 1948. In the

TABLE 19—CONSOLIDATED POSITION OF SCHEDULED BANKS IN INDIA AND PAKISTAN DURING AUGUST 1947—JUNE 1948.

(Source:—Reserve Bank of India Bulletins and Report on Currency and Finance: Reserve Bank of India.)

Lakhs of Rupees

Month and Year	Demand liabilities	Time liabilities	Savings Deposits	Total Time and Demand liabilities	Cash in India and Pakistan	Balances with the Reserve Bank	Excesses over statutory minimum	Total Cash and Balances with the Reserve Bank	Advance in India and Pakistan	Bills discounted	Total advances and Bills discounted
1	2	3	4	5	6	7	8	9	10	11	12
Aug 1947	621,09 (65,18)	303,91 (39,25)	140,64	925,00 (104 43)	35,83 (5 15)	107,28	66,10	148 26	365,61 (43,50)	15 06 (1,29)	425,46
Sept. „	634,71 (64,58)	306,92 (38,65)	142,04	941,63 (103 23)	35,67 (4,59)	116,38	74 50	156 64	359,13 (43 25)	14,35 (1,18)	417,91
Oct. „	643 93 (65,15)	313 00 (31,16)	142,83	956,93 (96,31)	35,21 (4,35)	111,73	69,39	151,29	365,47 (37,27)	13,73 (95)	417,42
Nov. „	650,95 (73,79)	312,45 (30,51)	144,76	963,40 (104,30)	35,57 (4,62)	101 27	58,17	141 46	368,78 (37,04)	15,12 (94)	421,88
Dec. „	652,41 (79,81)	314,91 (27,39)	145,85	967,32 (107,19)	36,19 (3,89)	109,00	65,54	149 08	374 81 (38,20)	17,09 (1 06)	431,16
Jan. 1948	660,65 (83,87)	316 16 (23 86)	146 30	976,81 (107,73)	36,46 (4,30)	95 04	51,01	135,80	407,62 (39,45)	17,98 (97)	466,02
Feb. „	664,09 (80,83)	317,07 (21,30)	147,76	981,16 (102,13)	35,99 (3,99)	96 70	52 69	136 68	426 29 (39,89)	15,97 (91)	483 06
March „	670,38 (81,04)	319 37 (20,86)	149,71	989,75 (101,90)	36 17 (3,87)	83,10	38,72	123 14	435,65 (39,16)	16 87 (89)	492,57
April „	688,66 (82,78)	313,60 (19,51)		1,002,25 (102,29)	36,95 (4,04)	84,44		125,43	440,60 (37,16)	17,22 (86)	495,84
May „	687,12 (83,09)	313 72 (18,12)		1,000,84 (101,21)	38 30 (3,87)	90 82		132,99	435,69 (33,22)	16,73 (59)	486 23
June „	692 55 (85,59)	312,66 (17,81)		1,005,20 (103,40)	39 28 (3,67)	98,18		141,13	434,72 (32,19)	15,93 (59)	483,43

Figures in brackets are for Pakistan.

Issue Department gold coin and bullion and Sterling Securities were unchanged throughout the period. The Rupee Securities were unchanged at Rs. 57·84 crores upto January 1948 and then increased to Rs. 127·84 crores in June 1948. In the Banking Department "Balances held Abroad" declined from Rs. 388·09 crores in August 1947 to Rs. 373·18 crores in January 1948 and then showed a rising trend and stood at Rs. 405·62 crores in June 1948. This increase in the Rupee Securities in the Issue Department of the Reserve Bank of India was in connection with the payment to Pakistan of her share of the Government cash balances.

§ 26. *Bank Deposits.*—Table 19 gives the consolidated position of scheduled banks during August 1947—June 1948. The demand deposits of scheduled banks increased from Rs. 634·71 crores in September 1947 to Rs. 692·55 crores in June 1948. Time deposits dropped sharply during September 1947 but during subsequent months showed a slight rise. Cash and balances with the Reserve Bank of India together were 14·40 per cent. of the total deposits in August 1947. The percentage, after fluctuating a little, came down to 11·36 in April 1948 but increased to 12·73 in June 1948. The bills discounted and advances together were about 41 per cent. of the total deposits in August 1947. This percentage

TABLE 20—MONEY RATES IN INDIA FROM AUGUST 1947 TO JUNE 1948

(Source :—Report on Currency and Finance : Reserve Bank of India and Reserve Bank of India Bulletin.)

Month & Year	Call Money Rates		Bazar Bill Rate		Average Treasury Bill rate	Deposit Rates		
	Calcutta	Bombay	Calcutta	Bombay	per cent. per annum	3 months	6 months	12 months
August 1947	$\frac{1}{2}$	$\frac{1}{2}$	9 to 10	$7\frac{1}{2}$	...	$\frac{3}{4}$ to 1	1 to $1\frac{1}{2}$	$1\frac{1}{2}$ to $1\frac{3}{4}$
September	$\frac{1}{2}$	$\frac{1}{2}$	9 to 10	$7\frac{1}{2}$	0·38	$\frac{1}{2}$ to $\frac{3}{4}$	$\frac{3}{4}$ to 1	$1\frac{1}{2}$ to $1\frac{3}{4}$
October	$\frac{1}{2}$	$\frac{1}{2}$	9 to 10	$7\frac{1}{2}$	0·44	$\frac{1}{2}$ to $\frac{3}{4}$	$\frac{3}{4}$ to 1	$1\frac{1}{2}$ to $1\frac{3}{4}$
November	$\frac{1}{2}$	$\frac{1}{2}$	9 to 10	$7\frac{1}{2}$	0·50	$\frac{1}{2}$ to $\frac{3}{4}$	$\frac{3}{4}$ to 1	$1\frac{1}{2}$ to $1\frac{3}{4}$
December	$\frac{1}{2}$	$\frac{1}{2}$	9 to 10	$7\frac{1}{2}$	0·50	$\frac{1}{2}$ to $\frac{3}{4}$	1 to $1\frac{1}{4}$	$1\frac{1}{2}$ to $1\frac{3}{4}$
January 1948	$\frac{1}{2}$	$\frac{1}{2}$	9 to 10	$7\frac{1}{2}$	0·50	$\frac{1}{2}$ to $\frac{3}{4}$	1 to $1\frac{1}{4}$	$1\frac{1}{2}$ to $1\frac{3}{4}$
February	$\frac{1}{2}$	$\frac{1}{2}$	9 to 10	$7\frac{1}{2}$	0·49	$\frac{1}{2}$ to $\frac{3}{4}$	1 to $1\frac{1}{4}$	$1\frac{1}{2}$ to $1\frac{3}{4}$
March	$\frac{1}{2}$	$\frac{1}{2}$	9 to 10	$7\frac{1}{2}$	0·50	1 to $1\frac{1}{4}$	$1\frac{1}{4}$ to $1\frac{1}{2}$	$1\frac{3}{4}$ to 2
April	$\frac{1}{2}$	$\frac{1}{2}$	...	...	0·49	$1\frac{1}{8}$	$1\frac{3}{8}$	...
May	$\frac{1}{2}$	$\frac{1}{2}$	...	...	0·50	$1\frac{1}{8}$	$1\frac{3}{8}$	...
June	$\frac{1}{2}$	$\frac{1}{2}$	...	...	0·49	$1\frac{1}{8}$	$1\frac{3}{8}$	...

had increased to about 45 in June 1948. The ratio of bank clearings to demand deposits declined to 8·4 during 1947–48 from 9·3 in 1946–47.

§ 27. *Money Rates.*—Table 20 gives the money rates in India in 1947–48. The call money rate and rates on deposits of 3 and 6 months remained unchanged but the bazar bill rate showed a further hardening over that of the previous year. So also the Treasury Bill rate had slightly moved up during the year.

§ 28. *Capital Issue.*—The information regarding the various capital issues consented to and refused under the Capital Issue Control Order during 1947–48 shows that the amount of capital issues for immediate schemes consented to was Rs. 101·79 crores in 1947–48 as against Rs. 161·09 crores during the 1 October 1945 and 31 March 1947. The amount of long range scheme issues sanctioned was Rs. 61·20 crores in 1947-48 as compared with Rs. 218·87 during October 1945—March 1947. The figures for 1947–48 are, after 15 of August 1947, for Indian Dominion only. Taking this fact into consideration the amount of capital issues for immediate schemes during 1947–48 was comparatively higher than during the previous year. As against this, however, the total number of applications and the total amount asked for had comparatively fallen. During 1947–48, 541 applications asking for an amount of Rs. 193·10 crores were received, as compared with 1614 applications asking for an amount of Rs. 483·91 crores during 18 months ending 31 March 1947. There seemed to be a general liberalization in the policy regarding consent during 1947–48.

§ 29. *Interim Budget.*—An interim budget covering the period from 15 August 1947 to 31 March 1948 was presented by Mr. Chetty, the Finance Minister, on 26 November 1947. He estimated the total revenue receipts at Rs. 171·15 crores and total expenditure at Rs. 197·39 disclosing a deficit of Rs. 26·24 crores. This was proposed to be reduced to Rs. 24·59 crores by replacing the then existing export duty of three per cent. on cotton cloth and yarn by a duty of four annas per square yard on cotton cloth and six annas a pound on cotton yarn. This was expected to yield during the period of the budget a sum of Rs. 1·65 crores.

The Finance Minister disclosed that the public seemed to display hesitation in taking up Government loans and consequently Government's internal borrowing programme was not getting a satisfactory response. He stated that Government would not reverse its cheap money policy but efforts would be directed towards consolidating and stabilizing the position so far gained in this respect. The Finance Minister claimed that the budget deficit was a result of the abnormal conditions in the country. "I have no doubt that once we reach normal conditions and are able to reduce our Defence expenditure to peace time proportions and curtail

our reliance upon import of foodgrains we should be able to balance the budget ... With a determined all round effort we should be able to achieve this result in 1949–50." [27]

The Capital Budget for 7½ months estimated capital receipts at Rs. 30·64 crores and the disbursements at Rs. 164·97 crores. The deficit on capital account thus came to Rs. 134·34 crores. While receipts from new loans during the period were put at Rs. 40 crores, expenditure on the discharge of permanent debt was put at Rs. 59·57 crores.

§ 30. *Budget 1948–49.*—The Revised Estimates for the period covered by the Interim Budget showed revenue receipts at Rs. 178·77 crores and the expenditure at Rs. 185·29 crores, thus leaving a deficit of Rs. 6·52 crores.

At the then existing level of taxation the revenue receipts for 1948–49 were estimated at Rs. 230·52 crores and expenditure charged to revenue at Rs. 257·37 crores, leaving an expected deficit of Rs. 26·85 crores. Allowing for the contribution of Rs. 4·5 crores from the railway surplus, the deficit was reduced to Rs. 22·35 crores. This increased to Rs. 28·81 crores as a result of tax concessions made by the Finance Minister. These were firstly, reduction of the rate of the profits tax from 16⅔ per cent. to 10 per cent. and increase in abatement from Rs. 1 lakh or 6 per cent. of capital employed to Rs. 2 lakhs or 6 per cent. of the capital employed. Secondly, the raising of the limit at which the maximum rate of super-tax is attracted to Rs. 3½ lakhs for both earned and unearned incomes. Thirdly, reduction by one anna of the tax on the undistributed profits of companies. Fourthly, reduction of the income-tax on companies with an income of Rs. 25,000 and below to half the usual rates. Fifthly, raising of the corporation tax from 2 annas to 3 annas and allowing a rebate of one anna to companies which declare and distribute their dividends in India. Sixthly, conversion of the export duty of 6 annas a pound on cotton yarn into an *ad valorem* duty of 25 per cent. exemption of the handloom cloth from the duty. Seventhly, abolition of the excise duty on betelnuts.

Expressing the view that "in the present inflationary conditions it is necessary to reduce, as far as possible, the gap between revenue and expenditure and, if it is at all possible, to have a surplus budget," the Finance Minister proceeded to explain the new taxation proposals. In the first place, the deficit was to be reduced by Rs. 10 crores by taking to revenue directly advance payments of income-tax, as these were not in the nature of refundable deposits. For raising additional tax revenue the Finance Minister made the following proposals: (i) Levying of an export duty of Rs. 80 per ton on oilseeds and Rs. 200 per ton on vege-

27. *Indian Information*, 15 December 1947.

table oil; (ii) An export duty of Rs. 20 per ton on manganese; (iii) Raising of the import duty on motor cars from 45 per cent. to 50 per cent. with a preference of 7½ per cent. in favour of the U. K., and the import duty on cigars, cigarettes and manufactured tobacco; (iv) Levying of an excise duty of 25 per cent. on ex-factory prices of cigarettes and raising of the duty on unmanufactured tobacco; (v) Raising of the excise duty on tea and coffee to 4 as. per lb.; (vi) Raising of the duty on Vegetable Product and motor tyres by 50 per cent; (vii) Raising of the duty on matches from Rs. 1–12–0 per gross for boxes containing between 40 and 50 matches to Rs. 2–8–0 per gross on all boxes containing upto 50 matches; (viii) Raising of registration rates and surcharge on trunk telephone calls. These measures were expected to yield an additional revenue of Rs. 17·72 crores. The deficit was thus reduced to Rs. 1·09 crores, which was left uncovered. According to the Finance Minister, if the estimated interest of about Rs. 9 crores due on the partition debt from Pakistan was taken into account the deficit would be converted into a substantial surplus.

The revised capital budget for the interim period revealed the deficit on capital account to be Rs. 133·41 crores. The capital budget for 1948–49 put the receipts during the year at Rs. 174·07 crores and the disbursements at Rs. 286·57 crores, leaving a deficit of Rs. 112·50 crores. Under receipts new loans were expected to contribute Rs. 150 crores. On the other hand the discharge of permanent debt was expected to cost Rs. 103 78 crores. The net new borrowing of the Government during the year was thus expected to amount to Rs. 46·22 crores. Under disbursements grants and loans to provinces for development aggregated to Rs. 68 crores.

The Finance Minister spoke at the outset on the financial and economic problems facing the country and the principle on which this budget was framed. He observed: " A view that has in recent years become almost unanimous among economists and financiers that each year a Government's financial policy should be so planned as to rectify the economic maladjustments of the time and to serve as a compensatory device to affect fluctuations in the private sector of economy. ... An inflationary pressure resulting from too much money chasing too few goods has been the keynote of our present economy, and there is no indication that a reversal of this trend is in sight. At such a juncture we should exert every nerve to budget for a surplus, if possible, by increasing revenue and curtailing expenditure. The methods by which these aims are achieved are important because as the present phase of inflation is due to an abundance of spending power without the goods to spend on, we must see that a surplus is achieved in such a way as to curtail spending and create suitable incentives for increasing production. In other words, the tax burdens laid must be met by cutting down expenditure on consumption and not by saving. ... Similarly, the

borrowing made must be from genuine savings and not from inflated bank credit. The practical application of these principles is indeed difficult, but we must bear them in mind in shaping our financial policy."

§ 31. *Government Borrowing.*—The $2\frac{3}{4}$ per cent. 1962 cash-cum-conversion Loan for Rs. 40 crores was placed on the market on 15 November 1947. The total subscriptions including the amount taken by the Government amounted to Rs. 40·85 crores. Of these Rs. 20·84 crores were by tender of cash and Rs. 20·01 crores by way of conversion of the $3\frac{1}{2}$ per cent. 1947–50 Loan. There were no other issues during the year.

The $3\frac{1}{2}$ per cent. 1947-50 loan was repaid during the year. Of the outstanding balance of Rs. 55·94 crores of this loan, Rs. 20·01 crores were redeemed by conversion as noted above and the remaining Rs. 33·96 crores was repaid upto 31 March 1948.

§ 32. *Food Policy.*—At the end of September 1947, the Government of India appointed the Foodgrains Policy Committee, with Sir Purshottamdas Thakurdas as its chairman, "to advise Government on (i) measures which can be taken to increase domestic production and procurement (ii) the extent to which reliance can and should be placed on imports and (iii) in the light of the above, modifications which may be necessary in the foodgrains policy so far pursued." In advance of other matters referred to it, the Committee decided to consider the question of policy to be pursued and the measures to be taken in respect of the procurement and distribution of foodgrains during 1948 and communicated its recommendations to the Government on 17 October 1947. The Interim Report giving reasons for these recommendations was signed on 22 December 1947 i. e. after the Government of India had announced their decision on food policy by accepting the recommendations of the Committee !

The Committee, after examining the problem, came to the conclusion that the existing food controls had failed to serve their purpose. There were several complaints about their working such as (i) the heavy cost of administration (ii) bad quality of grain distributed (iii) losses sustained in storage and transit and (iv) corruption in the army of functionaries. But even ignoring these by regarding them as inevitable in state trading, controls were not fulfilling the purposes for which they were intended. The main features of the situation were (a) Decreasing procurement, attended by increasing difficulties; (b) Decreasing scales of ration attended by increasing difficulties in maintaining these scales and depletion of government stocks: (c) Steadily increasing demand for imports from abroad. Such heavy imports at high prices deemed necessary under controls make heavy drafts on foreign exchange

resources of the country which are none too ample.[28] Table 21 gives data furnished by the Committee which are useful in this connection.

TABLE 21—PRODUCTION, PROCUREMENT AND IMPORT OF FOODGRAINS IN INDIA DURING 1943–47

(Source :—Interim Report of Foodgrains Policy Committee—1948).

Year	Production (million tons) (Excluding Madras)	Procurement (million tons)* (Excluding Madras)	Period	Quantity of Imported grain (lakh tons)	Total Cost Rs. (Crores)	Cost of subsidy met by Government of India excluding that met by States Rs. (Crores)
1943–44	46·54	4·10	...	...	...	...
1944–45	44·01	3·78	...	...	...	...
1945–46	40 33	3 67	April—March 1945 1946	9 31	26·00	nil
1946–47 (upto 25–9–47)	41·07	2·83	April—March 1946 1947	26·58	88·70	20·59
			April-December 1947 1947 (estimated)	19·12	77·97	17·50

* Represent procurement of Kharif grains during the 12 months ending 31 October of the year to which they relate and procurement of Rabi grains during the 12 months beginning with 1 May of the year to which they relate.

"It seems to us clear from all this that the system of food controls is unable to fulfil the purposes for which it was intended: what is more, it looks as if the system will fail increasingly. The country appears to have fallen into a rut, in which this condition of continuing food crisis is likely to perpetuate itself in an artificial manner. We use the word, 'artificial' advisedly. For, as already explained, it is not as if the entire population is being rationed and supplied exclusively from Government stocks. There are large areas where no rationing prevails, and where the population secures its supply from the free market. Even in areas which are under some form or other of rural rationing, the system does not aim at securing the full available surplus (e. g. Bombay). In other areas where the system does aim at securing the full surplus, the administrative difficulties involved in working the system appear to be very great. In these circumstances, we believe a great deal of grain

28. The Minority Report pointed out that the imports of foodgrains during recent years were consistent with the trend of foodgrain imports in the inter-war period and that they were necessary partly to meet the short fall resulting from two successive bad seasons and the substantial reduction of carry-overs during the war. Apart from these it should be remembered that the Committee appeared completely to have neglected the effects of the partition of the country on its food position Because of the partition the food deficit of the Indian Union increased by about 7 to 8 lakh tons.

tends to remain in the villages. This inference is supported by the common experience of most people about the ease with which grain is obtainable in the free market. The result of every decrease in the scale of ration allowed is that the relatively small proportion of the population which is effectively rationed in urban areas tends to suffer. The demand on the free market increases. This widens the gap between the controlled price and the price actually prevailing in the free market. The tendency for the free market to convert itself into an illegal black market thereby increases. The more grain is sold in the black market, the greater the drop in procurement and this necessitates a further decrease in the scale of ration. A vicious circle is thus set up, the inevitable result of which must be increasing maldistribution of available stocks, exaggeration of such shortage as may be prevailing in parts of the country, a distorted and alarming picture of the imminence of famine entirely unjustified by the actual supply situation and general increase in the dissatisfaction of all sections of the public with the measures taken by the Government to deal with the food situation."[29]

For these and other reasons the Committee thought that an entirely different approach to the problem was necessary. With this aim the majority of the Committee made the following main recommendations:

(i) Reduction of Government commitments under rationing and controlled distribution. (2) reduction to be effected in the reverse order to the original process of extension.

An increase in the procurement price of controlled foodgrains was necessary. The extent of this increase to be settled according to the procedure laid down.

A ceiling to be fixed for imports from abroad during 1948 and the decision to terminate its dependence on imports to be announced by Government.

The basic export quotas and ceiling import quotas for provinces and states were fixed by the Committee.

Inter provincial movement of foodgrains to continue to be controlled. Control on movements within the province should be removed.

Statutory control over the prices of foodgrains, apart from the liability to deliver either on a monopoly or a compulsory levy basis at a fixed price, to be removed.

The Minority recommended that there should be no relaxation of any existing control over foodgrains during 1948. That relaxation of controls should begin as soon as possible after supplies sufficient for honouring all commitments on 12 oz. per capita basis, throughout the year, in all parts of the country are assured, together with a margin for emergencies.

29. *Interim Report of the Foodgrains Policy Committee*, 1948, para 19.

The conclusions and recommendations of the Committee were communicated to the Provincial Governments by the Government of India and their views were invited. The whole problem was discussed at the Conference of Food Ministers from Provinces and States which met in Delhi early in November 1947. The views expressed by the Provincial and State ministers at this conference showed "that while there was no difference of opinion over the ultimate objective of decontrol of food, there was considerable misgiving over the recommendation of the Foodgrains Policy Committee to reduce Government commitments under rationing and controlled distribution. An overwhelming majority of the Ministers favoured the continuation of the existing controls over foodgrains till the grain position materially improved."[30] In spite of this the Government of India, after further discussing the problem with Provincial Premiers on 23 November 1947, decided to adopt a policy of progressive decontrol as recommended by the Foodgrains Policy Committee after, in the words of the Food Minister, "anxious consideration and not without some hesitation." This decision was announced in the Dominion Parliament on 10 December 1947.

Detailing the reasons for adopting this policy in the Union Parliament Dr. Rajendra Prasad, the Food Minister, stated that the difficulties of control had multiplied steadily because of the widening gap between demand and supply and a breakdown of the whole structure was inevitable. The cost of imports of foodgrains was also mounting. The policy of decontrol had succeeded in regard to oils and oilseeds. Moreover, "Within recent months Hon'ble Members are aware that Mahatma Gandhi has raised his powerful voice against control. That is sure to make the continuance of control even more difficult than it has been in the past". There is the risk of price rise in the policy of decontrol but "the rise in the prices, I imagine, will not be more than what is prevalent in the black market." The price rise will only affect a part of the population. The Food Minister, while replying to the debate on the new food policy added, "I did not bring in the name of Mahatma Gandhi to support the policy of decontrol. I mentioned him as a difficulty in the way of maintaining the controls. Pandit Kunzru thinks that that is the argument in favour of decontrol. To many people that *should* (Italics ours) be a conclusive argument. In this country we have seen that it has proved a conclusive argument on many points. I can say from my own experience extending over 30 years of my close association with him that my intellect and my logic have very often failed to reconcile themselves to what I call his prescience or what Pandit Kunzru will call his instinct. But I have found that his instinct has proved to be true and my intellect and logic have proved to be false. I am not without hope that, in this case at any rate, his instinct will prove to be true and all our intellect, all our intellectual gymnastics and logic will prove to be false".[31]

30. Indian Information, December 1, 1947, p. 315.

31. *Indian Information*, 1 January 1948.

The implementation of the new food policy was left to the Provinces and the following chart reproduced from *Agricultural Situation in India* (April 1948), will show how different provinces implemented it.

Province	Procurement	Price Control	Rationing
1	2	3	4
Assam	Monopoly procurement will continue	No statutory maximum prices fixed now	Rationing abolished
C. P.	Monopoly procurement discarded	No statutory price control existed even before announcement of revised food policy	,, ,,
Orissa	Monopoly procurement continues	No control on maximum prices	,, ,,
Bombay	Monopoly system of procurement abolished	Statutory price control removed	Only Greater Bombay Ahmedabad, Poona and Sholapur now rationed.
West Bengal	Monopoly system of procurement in surplus areas retained	Price control retained	Rationing confined to Calcutta and Darjeeling only
Bihar	Monopoly system of procurement given up but levy system retained	Statutory price control removed	Only Jamshedpur now fully rationed. But Government also responsible for feeding industrial labour. Statutory rationing withdrawn from Patna from 17-2-1948 but essential services personnel having incomes of less than Rs. 150/- p. m. still rationed.
Madras	Monopoly procurement will continue in surplus districts only. In deficit districts there will be a voluntary levy system	Statutory price control removed	Rationed population in the neighbourhood of 8 millions
U. P.	No compulsory procurement but Government might buy foodgrains through trade channels	,, ,,	In 9 towns ration admissible only to people earning less than Rs. 100/- p. m.
East Punjab	Monopoly procurement of rice only will continue now	Statutory control over maximum prices of all foodgrains excepting rice removed	Rationing intact in most areas

The thinking elements in the country regarded the prospect of decontrol of food with alarm. The reasons underlying the alarm were pointedly brought out by the Commodity Prices Board, in their note on *Controls and their Continuation.* According to the Board: The immediate effects of decontrol may be considered in relation to supply and distribution of commodities and the levels and structure of their prices. A review of the Indian situation shows that the supply of both consumers' and producers' goods is limited by physical factors and by considerations that cannot be affected merely by the price. If an increase is brought about in any particular direction it will be at the cost of a decrease in supply in other directions, as for example, the diversion of acreage from one crop to another. Decontrol was not likely to increase supplies except by dishoarding which was bound to be small in quantity and only temporary in character. Decontrol would certainly increase prices, the extent of increase depending on the intensity of demand, availability of substitutes at higher prices and fear of reaction on the part of consumers. The pressure of demand generated by increased agriculturist incomes and incomes of industrial labour, kept in check so far by controls, will be more intense after decontrol. In almost all important consumers' goods, the possibility of substitute supplies is not considerable. The consumption of essentials is at such low levels in India that it is impossible to think in terms of a consumers' strike. There is therefore nothing in the situation that will keep the rise of prices after decontrol within moderate margins. The rise may be specially marked in poor and out of the way regions because under free distribution there is a natural tendency for the supplies to be first moved to urban centres where the demand is highly concentrated and where costs of transport and marketing are low. For the same reason poor and backward regions will be starved of supplies. Substitute supplies in the shape of imported consumer goods would be available chiefly to the middle and rich classes living in towns. Again the seasonal production of agricultural goods makes their price and supply, under uncontrolled conditions, liable to manipulation by speculators during the off season of agriculture in the absence of a free and rapid movement of supplies, external and internal. As the prospects in this latter respect were not bright decontrol was likely to lead to harmful results. Increase in the prices of commodities react upon each other. Prices of consumers goods influence wages and salaries and through them the cost of manufacture. The rise in prices, after decontrol, would bring about a general cumulative rise in the price level. So long as supply of commodities in the world as a whole is insufficient to meet effective demand the rise in the price level will make the problem of the adjustment of internal to external prices still more difficult. The disbanding of controls will leave the Government helpless to deal with a price recession when it comes. It will also not be possible to implement Government's long range plans of economic development without a regime of controls. Developments after decontrol described below will show that most of these expectations substantially came true.

There is no doubt that the Foodgrains Policy Committee completely misconceived and misjudged the food situation in the country. Instead of appreciating the real shortage of foodgrain supplies in the country, it proceeded to characterise it as "artificial", as resulting from controls and the panic they engendered. The need for large imports was felt to be due also to controls. They failed to appraise the supply position as arising out of two successive bad seasons and as affected by the recent partition of the country. Indeed, a reading of the Interim Report leaves an impression that the majority of the Committee had set their heart on decontrol and any considerations going against this either hardly occurred to them or if they did, were thought to be unimportant. The consequences of the decontrol policy discussed below show this beyond doubt.

The decontrol policy was launched under the most favourable circumstances. The agricultural seasons had been good in the country excepting Madras. Internal food production, as declared by the Food Minister, was higher inspite of the bad crops in Madras. Import position had also been more favourable than in any year during or after the war. The circumstances were thus the best possible for the success of the decontrol policy.

As can be seen from the earlier discussion, two things were expected to flow from the adoption of the policy of decontrol namely (1) Dishoarding on a large scale will do away with food scarcity and though prices will rise in the first instance they will tend to come down later as supplies increase. (2) Dependence on imports from abroad will be considerably reduced and finally ended. How far were these expectations fulfilled ?

Regarding the dishoarding of stocks no statistical information is available. It has to be inferred from market reports. Market reports from all over the country since January 1948 are replete with complaints about the heavy hoarding that had been going on and the price rises resulting from it.[32] The movement of foodgrain prices also partly reflects this. In Table 22 indices of foodgrain prices in U. P. and Bombay are presented. The average of wholesale prices of rice, wheat, jowar and gram at five important markets in C. P. and Berar are also presented. Both in the U. P. and Bombay cereal prices have shown an almost continuous increase from December 1947 and the extent of the price rise is, roughly speaking, more than 150 points. In the most important surplus province, C. P. and Berar, also prices have in some instances shown violent ups and downs and the general trend is upwards, the extent of the price rise from November 1947 to November 1948 ranging between 38 per cent. in rice and 133 per cent. in wheat.

32. Cf. Agricultural Situation in India, C. P. and Berar Gazette, etc.

TABLE 22.—INDICES OF FOODGRAIN PRICES IN BOMBAY, U. P. AND C. P. AND BERAR DURING THE PERIOD OF DECONTROL

[Sources :—(1) Bulletin of the Bureau of Economics and Statistics, Government of Bombay. (2) U. P. Monthly Bulletin of Statistics, (3) C. P. and Berar Government Gazette.]

U. P. Base 1939=100	Rice	Wheat	*Total cereal	*Total non-cereal	*General
Nov. 1947	338	382	406	351	395
Dec.	338	382	399	342	387
Jan. 1948	320	523	418	303	395
Feb.	320	554	427	279	398
March	320	554	406	283	381
April	400	554	432	291	404
May	440	585	459	318	431
June	480	615	493	320	459
July	500	723	546	322	501
August	520	769	575	322	524
Sept.	540	769	583	330	533

	‡Central Provinces and Berar (*Price in rupees per 10 maunds*).			
	Rice	Wheat	Jowar	Gram
	Rs as.	Rs. as	Rs. as.	Rs. as.
Nov. 1947	106—5 (100)	125-13 (100)	82—4 (100)	104-13 (100)
Dec ,,	116—4 (109)	139—2 (110)	89—2 (108)	129—2 (123)
Janu. 1948	120—4 (113)	204—9 (161)	95—10 (116)	126—8 (121)
February	127—8 (121)	271—0 (213)	66—4 (81)	119—5 (113)
March	149-11 (141)	249—5 (198)	103—0 (125)	115—1 (110)
April	172—0 (162)	253—5 (201)	143—2 (174)	123—9 (117)
May	145-14 (137)	287-14 (230)	150—0 (182)	154—1 (147)
June	144—6 (136)	269—8 (212)	123—5 (150)	138-11 (132)
July	145-12 (137)	271—0 (212)	131-14 (159)	139—7 (133)
August	144-14 (137)	221—9 (176)	112-10 (136)	141—5 (135)
Sept.	141-12 (132)	285-12 (223)	119—6 (145)	141-10 (135)
Nov.	147—7 (138)	297—3 (233)	130—8 (158)	156—7 (149)

* **Weighted.**

‡ **A simple average of Wholesale Prices at the five important grain markets in C. P. and Berar—Jubbulpore, Harda, Nagpur, Raipur, Amaraoti.**

Bombay	Rice	Wheat	Jowar	Bajri	Combined Index
Pre-decontrol	100	100	100	100	100
January 1948	193	313	168	190	209
February	209	273	176	202	211
March	242	240	173	206	219
April	266	245	180	209	232
May	286	250	195	218	247
June	304	255	207	229	260
July	306	257	206	229	261
August	294	250	201	218	253
September	294	253	203	213	254

The rise in prices of foodgrains gave rise to distress and Provincial Governments were soon forced to take steps to relieve it by opening cheap grain shops. The Centre was forced to give increased food allocations to Provinces for supplying these shops, and the demands on the Central reserves, instead of decreasing as expected after decontrol, grew continuously. Thanks to good seasons and larger imports there was no physical shortage of supplies. The shortage was largely a price shortage i. e. prohibitively high prices keeping supplies beyond the range of the pockets of common people.

The imports of foodgrains from outside since 1 January 1948 have been the highest during and after the war. Upto the middle of September 1948, 2·1 million tons had been imported. Imports were the main source from which the existing rationed areas were fed and the cheap grain shops supplied.

The policy of decontrol made the food situation in the country worse and distress was so widespread that the Government of India decided to reverse it and to impose controls again. This was announced towards the end of September 1948. In terms of distress and suffering it has been the most disastrous and costly experiment by the Government.

§ 33. *Textile Policy.*—On the recommendations made by the ad hoc Committee, appointed by the Government of India in February 1947 to investigate facts bearing on the prices of cotton textiles and those of the Commodity Prices Board, the Government of India decided, by a resolution released on 17 November 1947, (i) to put into force on 1 December 1947 the standardisation scheme as finally devised on the recommendations of the ad hoc Committee (ii) to refer the question of textile prices to the Tariff Board (iii) to start an Equalization Fund from 1 December 1947 to which was to be credited (a) the difference between existing ex-mill prices of fine and superfine cloth and the lower prices which the ad hoc Committee believe to be fair (b) half of the amount then being paid as quota holders' commission, which Government had decided to reduce from 3 to 1½ per cent. from 1 January 1948 and (c) a surcharge on sliding scale on " free " yarn sold by mills. Acting on this decision the Textile Industry (Control of Production) Order was issued on 1 December 1947 and was made effective from that date. The Cotton Textile Equalisation Fund Ordinance, 1947, was issued at the same time and the surcharge on cloth and yarn produced after 30 November 1947 was fixed by a notification under it on 13 December 1947.

The whole textile control policy was, however, reversed by the Government resolution dated 22 January 1948. It amounted to virtual decontrol. According to this resolution the textile mills were permitted

to work out their own production programmes. The then existing production targets and measures against hoarding, etc. were to be continued and the setting up of production Committees at all mills was to be promoted. The fixation of prices was left to the industry. The Equalization Fund was closed and the surcharge on cloth and yarn abolished. No subsidies were to be any longer paid and the system of quota holders was abolished. Every mill was required to keep 25 per cent. of its production at the disposal of the Textile Commissioner. The movement of textiles within a province was to be free but movement between provinces was to be sanctioned by the Textile Commissioner. A special excise duty on the existing stocks of cloth was to be levied. The system of yarn distribution was to continue. The control over export of cloth and over the distribution of machinery, imported mill stores, dyes, chemicals and sizing materials was to continue but control over the prices and distribution of imported cloth and yarn was to be abolished. The existing control machinery was to be retained for again imposing control if it became necessary.

By a resolution of 4 May 1948 the Government of India abolished with immediate effect the stamping of ex-mill and retail prices on cloth. The marking of the month and year of production was however to continue. The Textile Commissioner was to arrange for the supply of cloth to cooperative societies nominated by State and Provincial Governments, out of the portion of production held by each mill at his disposal. Control over dyes and hydro-sulphide of soda was removed. The Textile Control Board was abolished from 15 May 1946 and the Textile Advisory Committee was created. The functions of the latter were (i) To advise Government on cotton textile policy and particularly on the fairness of prices of cloth and yarn fixed by the industry (ii) To advise Government on matters pertaining to the development of textile industry, allocation of spindlage, loomage for expansion, assistance as regards raw materials, mill stores, coal, transport, etc. On 5 June 1948 three committees to advise the Textile Commissioner were appointed: (i) For working out prices of cotton textiles and to assist in the allocation of contracts for cotton textile materials. (2) To advise on questions relating to raw cotton. (3) To advise regarding the import and distribution of mill stores.

The results of the decontrol of textile prices and distribution of cloth can be best described in the words of the communique issued by the Government of India on 30 July 1948 announcing their decision to reimpose controls.

"The situation arising out of the gradual relaxation of control over the price and distribution of cloth since January 19, 1948, has been engaging the serious consideration of Government. Shortly after this date the prices of cloth began to rise, and since April 24, 1948, when

price-stamping was removed, the prices have, in some cases, risen to fantastic heights. Although since about the middle of June there has been some fall in wholesale prices from the heights reached before, there is no indication yet that the retail prices will come down in the near future.

" The policy since April 24, 1948 has been to have only a general control over movement. Production has increased since the beginning of this year by about 12 per cent. over the average of the last year. Cloth has also moved in large quantities from the main producing centres during the last three months. Indeed, the movement has generally been 20 per cent. to 40 per cent. more than at the time control was in existence. Nevertheless the fact remains that cloth has not yet become available to the consumer in adequate quantities or at reasonable prices. To a large extent this has been due to practices which reflect grave discredit on many sections of the industry and the trade.

"Government have now carefully considered the situation in the light of all the views expressed, and have come to the conclusion that a measure of control over both distribution and prices must immediately be reimposed.

" They have accordingly decided to take the following steps :—

"(i) To ensure that the productive capacity of the mills is fully utilised, Government will set up machinery to prevent a fall in production and the manufacture of unsuitable or non-durable cloth.

"(ii) Government will fix fair prices of cloth and yarn ex-mill. The Tariff Board which had been asked to report on the fair prices of cloth has recently submitted its report, and this is at present under consideration of Government. Pending a decision on the recommendations of the Tariff Board Government will fix prices *ad hoc*.

"(iii) Such prices will be stamped on all cloth and yarn ex-mill. Such stamping will be done on the existing stocks with the mills and orders have already been issued freezing stocks with the mills for this purpose.

"(iv) Distribution to provinces and States according to quotas will be only through wholesalers, approved or nominated by provincial Governments or States. They have already been requested to forward the lists of such wholesalers to the Textile Commissioner, and it is hoped that distribution of stamped cloth through these channels will begin very soon.

"(v) Of the cloth so distributed to provincial Governments and States, a certain amount will be distributed through shops controlled by them. The exact method of distribution must naturally be decided by them ; but it has been suggested to them that in the initial stages such controlled shops should cater to the needs of lower income groups.

"(vi) The balance of the cloth allotted to provinces and States will be distributed through consumers' co-operative societies and through normal trade channels. Provincial Governments and States will exercise a general supervision over such trade channels, and they have already been requested to introduce a system of licensing retail shops. It is not the intention to restrict, or to interfere with the working of these channels so long as the distribution is within the province or State concerned and the prices charged are correct.

"(vii) Retail shops in provinces and States, both controlled and uncontrolled, will be allowed to charge an extra margin over the ex-mill prices stamped on the cloth according to the rate fixed by the provincial Governments or States, for which the Central Government will prescribe a maximum.

"(viii) Powers will be assumed by the Central, Provincial and State Governments by which they can requisition cloth from wholesalers and dealers at prices considered fair by them. This power is intended to be used for checking hoarding, profiteering and other malpractices, and will be freely used.

"(ix) Although the primary responsibility of implementing the textile control will rest with provinces and States, an enforcement branch is also being immediately set up by the Central Government. Government will also assume adequate powers to deal drastically with the infringements of textile control in all its aspects.

"(x) The movement of stamped cloth from the mills to retail shops will naturally take some time. Meanwhile, there is a considerable quantity of cloth which is unstamped and which is at present with wholesalers and retailers. The sale of such cloth will be permitted up to October 31, 1948. The stocks of unstamped cloth are so large that, unless wholesalers and dealers engage in malpractices, there should be no shortage of cloth in the country during this period. Powers of requisitioning will be freely used if malpractices occur.

" Government will also, in consultation with the provinces and the interests concerned, take up immediately the question of controlling prices of Indian raw cotton. "

§ 34 *Transport.*—The Indian transport system, mainly the railways, have recently come in for a good deal of criticism. According to the pronouncements of many commercial and industrial magnates, the transport bottleneck has been mainly responsible for a retardation of production and the failure of distribution. The criticism has been, however, rather overdone in an attempt to make the railway system the scapegoat for all the economic distress of recent years. The letter of the Railway Board dated 3 September 1948 in reply to certain criticisms of the Federation of Indian Chambers of Commerce and Industry, released

to the public recently, makes this amply plain with facts and figures. As the matter is of some importance some relevant information from that reply may be usefully summarised here.

The Railway Board first draws attention to the nature and extent of demands being made on railway transport, *vis a vis* the designed capacity of Railways to handle this. " In the first place, partition alone has changed the trend of traffic; the port of Karachi can no longer be used by India; very large quantities of foodgrains continue to be imported from abroad; thousands of tons of coal, which in pre-war years went by sea, have to be railed across country; new industries have come into existence and older ones have developed in particular areas between 1938-39 and 1946-47. Through all this, the inherent capacity of railways to handle traffic has not changed substantially."

In spite of these and other handicaps the Railways have been moving considerable traffic, as shown by the following figures of the average monthly number of wagons loaded with goods of all descriptions. (figures exclude old N. W. and B. A. and E. P. and Assam Railways.)

Year	*Broad gauge*	*Metre gauge*
1944-45	284,764	124,067
1947-48	260,553	118,475

TABLE 23—GOODS AND PASSENGER TRAFFIC ON THE BROAD AND METRE GAUGE RAILWAYS IN INDIA DURING 1945-46—1947-48*

(Source :—Railway Board's letter dated 3rd September 1948 to the Federation of Indian Chambers of Commerce and Industry)

(in train miles)

Broad Gauge

Year	Goods	Passenger	Total
1945-46	41,514	39,881	81,395
1946-47	41,109	44,513	85,622
1947-48	39,343	45,282	84,625

Meter Gauge

Year	Goods	Passenger	Total
1945-46	16,955	18,275	35,212
1946-47	15,977	23,321	39,298
1947-48	14,282	25,152	39,434

* Excluding old N. W. and B. A. and E. P. and Assam Railways.

The figures for 1947–48, though they include the immediate post-partition period when traffic in certain areas was severely affected, show a decline of only 8·5 per cent. on the broad gauge and 4·5 per cent on the metre gauge over the peak war year 1944–45.

Another important group of statistics is contained in Table 23. Commenting on these figures the Railway Board observe: "The total train miles on the broad gauge are greater for 1947–48 than for 1938–39, the pre-war year. During 1945–46 the passenger train miles were drastically reduced, but for 1947–48 the passenger train miles are nearly up to pre-war level, and the goods train miles are greater. On the metre gauge the position is not quite as satisfactory in comparison, but an appreciable increase in the passenger train miles is recorded from 1945–46 figures."

The Railway Board gives figures set out in Table 24 to show that industries have not suffered for want of coal because of the railways.

TABLE 24—COAL DESPATCHES TO CERTAIN INDUSTRIES IN INDIA AND THE CORRESPONDING PRODUCTION IN THOSE INDUSTRIES DURING 1944-45 AND 1947-48.

(Source: Railway Board's letter dated 3rd September 1948 to the Federation of Indian Chambers of Commerce and Industry.)

Industry	Coal Dispatches (Million Tons)		Increase (+) or decrease (−) per cent.	Production		Unit of Production	Increase (+) or decrease (−) per cent
	1944-45	1947-48		1944-45	1947-48		
Iron and Steel	2·69	3·20	+18%	4·5	4·0	Million tons	−12%
Cement	0·76	0·79	+ 5%	2·0	1·6	,, ,,	−20%
Paper	0·38	0·42	+10%	2·0	1·4	,, Cwts,	−29%
Jute	0·43	0·69	+63%	1·1	1·0	,, Tons	−6 % (9 %)
Chemicals	0·10	0·13	+33%	1·6	1·2	,, Cwts.	−24%
Textiles Yarn	1·72	1·96	+14%	1,650	2,202	,, Lbs.	+33%
,, Woven				4,726	3,735	,, Yards	−21%

The following figures indicate the tonnage of foodgrains and cereals moved by rail before and after decontrol.

Month	Food grains. (In Wagons)	Other Merchandise. (In Wagons)
October 1947	33,199	359,302
November ,,	29,317	374,920
December ,,	31,885	431,969
January 1948	36,411	473,440
February ,,	41,015	479,634
March ,,	42,293	492,451
April ,,	43,017	468,778
May ,,	43,229	417,709
June ,,	41,069	400,737
July ,,	45,233	425,109

The figures effectively dispose of the contentions of those supporters of decontrol, who held the traffic bottleneck responsible for the considerable rise in foodgrain prices after decontrol.

Commenting on the delay in transit on the Railways the Railway Board remark: "Much of the cause for the slowness in transit and therefore of turn round and availability of wagons is due to delays at terminals. There are instances where wagons have been used to store goods, because, at the time, putting the goods on the market was perhaps not profitable to the consignee, and he therefore has been more willing to pay demurage, even, in this respect, in connivance with the local railway staff, has often escaped payment in consideration for a bribe which he has offered to them."

The main cause for the slower turn round of wagons was the shortage of locomotives, arising out of the very inadequate replacements and additions during the war period. This was not likely to be made good till about the end of 1950 as locomotives in adequate number were not available in foreign countries.

§ 35. *Monetary and Fiscal Policy*: The failure of the Government of India to recognise the intimate relation between the Government's fiscal policy and the monetary situation was one of the main reasons that led to the development of inflation in India during the war period. That it was a deficit induced inflation was only accepted during 1943-44. During the post-war period the inflation continued to be fed by budget deficits and retained its deficit-induced character. This is, however, not realised by those at the helm of fiscal affairs as is clear from their failure to grasp the real extent of the total budget deficit in post-war years. This is mainly due to the lack of comprehension of the new innovation in the budget since the termination of the war i. e. the division of the Central Government budget into a separate capital and a revenue budget. The point needs elaboration at some length.

The innovation of drawing up and presenting separate revenue and capital budgets was made in 1946-47. In explaining it the *Explanatory Memorandum on the Budget* for 1946–47 stated: "In the annual Financial Statement hitherto presented to the Legislature giving the Budget Estimates of the Central Government no attempt was made to give a picture of the Capital Budget. Statements A and B of the Financial Statement dealt with the Revenue and Expenditure Estimates, while Statement C enumerated the ways and means transactions of the Government in which are merged all transactions on capital account. With the growth of capital expenditure on post-war development the necessity for a proper presentation of the transactions of Government of a capital nature has become evident. This is an attempt to recast the form of the Budget so as to show separately the Revenue, Capital and ways and means transactions. The revised form in which the Budget Statement for 1946–47 has been prepared exhibits the estimates in three parts, namely :—

(a) Statement of the Revenue receipts and expenditure;

(b) Statement of the Receipts and Disbursements on Capital Account, and

(c) Statement of other receipts and disbursements.

The third statement incorporates the net surplus or deficit shown in the first two statements. There is no change in the information hitherto given. The change is only in the presentation of figures". In the two succeeding budgets no changes have been made in the set-up of these two budgets.

The above should make it clear beyond any doubt that the innovation does not in any way change the significance and character of the total Government receipts and disbursements shown in the third part of the budget, referred to above. The total deficit or surplus of the Government is represented by the sum of deficits and surpluses in both the budgets and not by the deficit or surplus as displayed in the Revenue Budget. This simple fact has not received the attention of Finance Ministers. While displaying extra-ordinary concern about the growing inflation in the country, they seemed to be showing no concern at all for the enormous deficits incurred on capital account, which have fed its rising tide. Sir Archibald Rowlands budgeted for a large surplus on capital account. While Mr. Liaquat Ali Khan presented a balanced capital budget, he did not seem to appreciate the significance of the huge deficit on capital account shown by the Revised Estimates for the preceding year 1946–47. Mr. Chetty went one worse. He did not even bother to balance the Capital Budget Estimates for 1948–49. Instead he budgeted for a large deficit. It could have been excusable in his Interim Budget but its recurrence in the 1948–49 budget strengthens, what

was formerly a vague suspicion, that Mr. Chetty did not regard the deficit on capital account as of any moment[33] and in giving the keynote of his 1948–49 budget as the attempt to budget for a surplus or at least a balance he was referring to the revenue budget only. That would, of course, make the statement completely invalid and incorrect.

Yet deficits have a nasty nack of persisting and making their presence felt, however indifferent an attitude the Minister of Finance may display towards them. The following shows the total deficits of the Government of India during 1946–47 and 1947–48 (7½ months) and the manner in which they have been met.

In Crores of Rupees

	1946–47	1947–48 (7½ months)
Deficit :		
On Revenue Account	45·29	6·52
On Capital Account	61·52	133·41
Total deficit	106·81	139·93
Financed by :		
Net Reduction in Central Government's Cash Balances	89·45	93·55
Net Increase in Total Notes issued	19·67	51·02
Total...	109·12	144·57

No figures regarding the receipts and disbursements of the Government of India during the 4½ months preceding the 15th August 1947 are available and hence the figures in the table refer to two separate periods. The implications of the figures presented above are abvious. If a government is not able to cover its total outlays during an accounting period from tax revenue and proceeds of borrowing during that

33. Cf. "A much more serious weakening—which was unfortunately by no means rare in the inter-war period—was a failure to collect (because of tax evasion) or perhaps even to plan for (because of the weakness of government) sufficient tax revenue to cover the current expenditure which had already been agreed upon. Governments in such predicament were accustomed to bundle all the uncovered expenditure—whatever its nature—into an "extra-ordinary" or "Capital" budget which for the foreseeable future at any rate had to be covered by borrowing, probably from the Central Bank. If "double budgeting" of this nature becomes chronic (as it was in danger of doing in France in 1930's) there is a risk of undermining confidence both in the financial institutions whose stability is threatened by the Government's importunity and even in a political system whose governments cannot keep their affairs in order" Ursula Hicks, *Public Finance*, 1947, p. 103.

period, the shortfall has to be made good by drafts on its accumulated cash balances, if it has any, or by borrowing from the Central Bank i. e. by fresh currency expansion. The Government of India has used both the devices for covering the gap.

The prospects during 1948–49 are not better. The deficit on revenue account is estimated at Rs. 1·0 crore while that on capital account is put at Rs. 112·50 crores. The actual deficit, however, is likely to be much larger. But even disregarding that possibility, the Government of India will have to draw on their reserves and/or to expand currency for meeting this deficit. At the beginning of 1948–49 the Government balances stood at Rs. 242·62 crores. If the Government does not borrow from the Reserve Bank for meeting the total budget deficit, the balances may be expected to be reduced roughly by Rs. 113 crores during the course of this year.

It should be pointed out here that during this year net currency expansion may be concealed, if the Government so chooses, by an apparent reduction or stability of the total notes issued. From 30 June 1948 the Reserve Bank ceased to function as the monetary authority of Pakistan and its assets would be divided between the two Governments. Pakistan's share of the assets of the Issue Department as noted earlier would be equal, subject to the adjustments enumerated in the 'Order' (Monetary System and Reserve Bank–Pakistan 1947,) to the total liabilty in respect of Pakistan notes outstanding on 30 June, 1948 and India notes which were legal tender in Pakistan on that date or in respect of which the rights of encashment in Pakistan existed on that date and which the Government of Pakistan might accept at par until 30th June 1949. Such notes from Pakistan will soon start pouring into the Reserve Bank and properly speaking, they along with the Rupee Securities temporarily placed in the Issue Department should be cancelled automatically. If any part of it remains uncancelled after being delivered to the Reserve Bank it will be a net addition to currency in existence in India.

The large budget deficits during the post-war period have been due to both a fall in borrowings and an increase in expenditure on current and capital account. The former was largely due to the accentuation of the inflationary momentum. The upward surge of prices discouraged savings because incomes did not increase proportionately. Partly also it resulted from the uncertainties of the political and communal situation and the speculative activity of traders on the relaxation of controls. Expenditure has increased mainly because of the schemes of reconstruction and development started by both Central and Provincial governments. The latter have been reimbursed by means of loans and advances to the tune of about Rs. 150 crores during 1946–49 for carrying out such schemes. Repayment of debt has also absorbed sums to the tune of

about Rs. 200 crores during 1946–49.[34] Government's expenditure in other directions is also rising such as that involved in implementing the recommendations of the Pay Commission. As prices increase larger dearness allowances and higher scales of salary have to be introduced. These in their turn put up prices and necessitate further increases in dearness allowances.[35] Recently the expenditure for refugee rehabilitation and the Kashmir war has also gone to swell the mounting tide of Government expenditure.

While Government outlays have been running high consumer incomes and expenditure, particularly the latter, have also shown a tendency to rise. Because of the steep rise in the prices of essentials, especially after the launching of the decontrol policy, consumers have had to spend more than formerly and a part of this has been made possible by the revision of pay scales, increases in dearness allowances, grants of bonuses, etc. during the post-war years. Because of the rising agricultural prices, incomes and expenditures of agriculturists have also tended to increase. As pointed out earlier, investment outlays have also been rising. There is a considerable amount of building activity both private and public. This rising tide of expenditures is reflected in the increasing demand for cash to spend commented upon earlier. Prices have as a consequence been continuously pushed upwards and at each successive round the situation has worsened further.

It might be argued that the spending of accumulated Government balances on reconstruction projects is productive expenditure and therefore justifiable, even on economic grounds. Use of Government balances for repayment of debts might be also held justifiable on similar economic grounds. Such an argument is, however, not tenable. For, firstly, it ignores the character of the balances of the Government of India. The balances accumulated during war are not the cumulative result of budget surpluses. They are mainly, as remarked earlier, expenditures provided for in the war budgets, but deferred, and therefore impounded in deposits, funds, etc. i. e they are funds arising out of inflationary finance during the war period which are for the time being laid up. Expenditures met by making drafts on these balances are financed by inflationary funds so far dormant. Such expenditure, when inflation has already developed to a high pitch, unleashes the latent inflationary

34 It should be observed in this connection that Government has been using its option to repay loans on a rather grand scale during the current year. By using the option of deferring repayment for a further period, a large part of the resulting outlay could have been avoided and Government expenditure curtailed to that extent.

35 Even the Central Pay Commission recommended that dearness allowances should be increased when the cost of living index rises by 20 points, *Report of the Central Pay Commission*, 1947, p 47.

pressure and aggravates inflation. The repayments of loans out of these balances produces exactly similar results.[36]

§ 36. *Inflation and Production.*—During the war and after, many official and non-official spokesmen in India have maintained that an increase in production is the only effective remedy against inflation. The Nehru Government has officially adopted the slogan "Produce or Perish". The Governor of the Reserve Bank of India and the Report of the Central Board of Directors of the Reserve Bank of India have recently given expression to similar views. That such a view essentially misconceives the problem has been pointed out before.[37] Since the misconceptions still persist some comments might be offered on them in the hope that a mere repetition of truth may dispel these old misconceptions.

In the first instance, it is necessary to bring out the implications of the way in which the problem has been recently posed by the Central Board of the Reserve Bank of India. In their report for the year ending 30 June 1948 they observe that "the root of the trouble in India is not so much over-spending as under-production." The two concepts "over-spending" and "under-production", must be analysed to grasp the implications of this statement. Over-spending can be interpreted to mean the tendency of spending a larger proportion of incomes than before and saving less. This is a necessary concomitant of any inflation and can even be said to be the essence of the inflationary process. To say that there is not "so much over-spending"[38] is to say in effect that there is not so much inflation. This is underlined by the other word 'under-production'. Under-production can only mean production below existing capacity.[39] To say that the root of the trouble

36 The belief that retirement of debt, held by banks, out of even a genuine budget surplus, checks inflationary forces by itself, is being increasingly questioned. Cf. Haberler, Causes and Cures of Inflation, *Review of Economic Statistics*, February 1948. Musgrave, Fiscal Policy in Prosperity and Depression, *American Economic Review*, May 1948. In India, where Government debt is held largely by individuals and institutions rather than by banks, the problem is somewhat different. Repayment of debts out of a genuine budget surplus, in this context, increases the purchasing power in the hands of the public and if inflation is already developed, this purchasing power will go to aggravate it. Debt retirement even out of a genuine budget surplus in the context of inflationary conditions, is positively inflationary.

37 Gadgil-Sovani, *War and Indian Economic Policy*, 1944, p. 141.

38 If the absence of overspending has been inferred from the falling velocity of circulation of bank deposits, it is quite illegitimate because the latter does not necessarily show a corresponding movement in income velocity which alone is relevant to over- or under-spending.

39 The Governor of the Reserve Bank of India said as much while addressing the Annual Meeting of Shareholders of the Bank on 9 August 1948...."the present output still being far short of even the existing capacity in the major industries,"

in India is 'under-production' is to say in effect that unused productive capacity exists on a significant scale in the country and is not being used. If there exists such unused capacity, under the pressure of rising prices it ought to come into use and lead to increased production. If it, however, remains unused even under such pressure this can only mean that the capacity cannot be put to use because of some non-economic considerations, such as technical considerations, etc. But the non-use of potential capacity because of technical deficiencies or similar non-economic considerations cannot be described as 'under-production' in the economic sense. By definition inflation cannot develop where unused productive capacity exists denoting 'under-production' in the economic sense of the term. The statement of the Central Board of Directors in effect denies the presence of inflation in the country. Yet the Report draws attention frequently to the presence and intensification of inflation in the country. This is a contradiction in terms [40]

The following from the speech of the Governor of the Reserve Bank of India is typical of those who insist on a production drive as the only effective remedy against inflation. "Our aim must be to bring about a fall in prices primarily by a sizeable increase in the volume of production of goods and services. This, however, need not rule out the possibility of some action in the monetary sphere ..." [41]

In examining this plea it is necessary to investigate, in the first instance, how much increase in production can be said to be "sizeable", in the present Indian context. The total currency in circulation in India has during the last nine years increased more than six times. The inflationary potential operating on the Indian economic situation is thus enormous and production will have to increase very considerably for producing at least some impression on the situation. Sizeable increase in the present context can be, at a rough guess, nothing less than 50–100 per cent. over the present levels. And even this will have to be achieved almost instantaneously before the inflationary situation gets worse. Otherwise the growing inflationary forces will neutralise the achievements in the field of production.

Such instantaneous and substantial increase in production can be achieved only if there is a correspondingly large unused productive

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40 It should be noted that Mr. G. D. Birla's argument for a production drive is at least free of such a logical fallacy because he positively asserts that there was and is no inflation in India. Cf. The speech of Mr. G. D. Birla to the Fifth Ordinary General Meeting of the United Commercial Bank Ltd., 22nd April 1948. *Commerce*, 24 April 1948. In this speech Mr. G. D. Birla asserted that a glance at the curve of effective currency i. e. currency adjusted for prices, production, velocity of circulation and hoarding, in India will reveal, that it is flat and not steeply ascending. The only comment on this is that on Mr. Birla's criterion there never was and never could be any inflation in the whole history of the world.

41 Annual Shareholders meeting, 9 August 1948.

capacity in the country which can be put into use immediately unhampered by shortages or bottlenecks. For an increase in productive capacity itself can be achieved only over a long period of time, even under complete and comprehensive economic planning. Is there at present in India, unused, for whatever reason, productive capacity of this magnitude? There is not. Hardly any unused productive capacity, at the present technical level, exists in agriculture. In the industrial field, according to the Governor of the Reserve Bank of India, the present output is still "far short of even the existing productive capacity in the major industries." This appears to be an exaggeration. Any unused capacity that exists at present is clearly occasioned by such circumstances as shortage of raw materials, coal, transport facilities, etc. But unused capacity, in this sense exists even under conditions of "over-full employment", such as those prevailing in the U. S. A. and the U. K. at present. During war years there was a net reduction of industrial capacity due to greater wear and tear and the very considerably reduced rates of replacement. Since the end of the war there has not been any significant net addition to industrial capacity in India. Because of the partition there has been probably some net decrease. In the circumstances, unused capacity can be only of a small magnitude. In any case it is too heroic an assumption, that the present unused capacity is such as to be capable of increasing industrial production substantially over present levels. In this connexion it needs to be pointed out that even in the U. S. A., which is in every respect infinitely more richly endowed than India, industrial production, with all the war time drive behind it increased by about 50 per cent. This was achieved both by using the formerly unused capacity and by using the new additions to the capital equipment. Even this increase was achieved at the end of four years. A little reflection on such facts should dispel all illusions about an immediate sizeable increase in production in India. Moreover, it should be remembered that industrial production is comparatively a small part of the total production in India and even a sizeable increase in the former will not significantly raise the level of total production in the country.

An increase in production at the existing productive capacity should be clearly distinguished from the increase in production by increasing that capacity. The former alone is relevant in the present Indian circumstances. Yet in the talk about a production drive both these are confused and, what is often meant by a production drive is the undertaking of large scale development schemes, aiming at an increase in productive capacity. Such a production drive, by increasing capital outlays, aggravates inflation rather than curb it. That is precisely what has been happening through the Government of India's capital budget.[42]

42 Financing of reconstruction plans by inflation was an important cause of the inflations that developed in European countries after World War I. Cf. *The Course and Control of Inflation—A Review of Monetary Experience in Europe after World War I*, League of Nations, 1946, Chapter I.

increase in productive capacity calls for increased capital investment, increased savings and is a long drawn out process. Such investment does not bear instantaneous fruit.

The plea for an increase in production as the only sovereign cure for inflation is more mischievous than appears at first sight. In India it has served as an effective camouflage for all capitalist elements The plea helps to gain numerous advantages to the industrialists and traders. Because controls on prices, distribution and production are supposed to reduce incentives to production and to arrest an increase in it, they should not be introduced. Those that are already in being should be forthwith abolished. All direct taxation also reduces production and investment incentives. Therefore direct taxation should not be increased but considerably reduced and a larger proportion of Government revenue should be raised by indirect taxation.[43] Imports of capital goods should have a priority over imports of consumer goods (including food) and foreign exchange should be conserved for this purpose instead of squandering it on imports of consumer goods, such as food, etc. New capital issues should be liberally permitted. Government's industrial policy should be such as to inspire confidence in the existing and prospective industry and talk about present or future governmental control of industry should be scrupulously avoided. Tariff protection to existing industry should be liberally extended and the internal prices should be protected from the impact of the low-priced imports from abroad.

With all this no responsibility attaches to the industrialists. If production, even with all the above conditions fulfilled, does not increase the blame can always be shifted to the shortage of raw materials, recalcitrant labour and, of course, transport difficulties. If prices rise abnormally, the blame can be put on traders, who return the same compliment to the industrialists. While this merry chatter goes on, with the Government watching helplessly, the other prices such as those of raw materials, wages, etc. catch up with the abnormally increased prices of manufactured products and the industrialists are able to claim that the new prices are warranted by increased costs. The stage is thus set for a fresh price advance and another round begins. At every stage scapegoats are galore.

43 The following from Prof. D. H. Robertson about English conditions with appropriate changes, might apply to the present situation in India. "As for the stiffening up of taxation, it is the essence of a boom that while it is really a time when output is high, it presents itself to the imagination as a time of stringency and shortage when it would be splendid if people could be induced to work harder and produce more; so that one set of counsellers will call for increased taxation to reduce inflation and others will be calling for reduced taxation for increasing incentive—which is just what has been happening while this chapter is being written." *Money*, Cambridge Economic Handbooks, Revised Edition 1948, p. 217.

The above is no imaginary account. Any body who has watched and followed recent events in India will readily recognize its conformity with facts. It also shows what innocent looking pleas mean actually in practice.

§ 37. *Prospects and remedies.*—The data and analysis presented so far clearly show that the inflation in India is deficit-induced and that it has been aggravated by the policy of decontrol by the Government of India. It would be readily realised that the recent upward movement of prices is the result of the inflationary spiral at work and there is little possibility of this movement coming to a stop automatically and remaining stable there. In India no internal or external factors can be expected to check the inflationary spiral. There appears to be little possibility, under the present dispensation, of any substantial decline in the current and capital expenditure of the Governments or the public. The possibilities of increasing production are distinctly limited in the short period and there is little prospect of the Indian economy 'growing up to the present currency' in the near future. External factors are also likely to be unhelpful. During the past year and a half prices have shown an upward trend in the world as a whole and inflationary tendencies in several countries have significantly strengthened. With the flow of Marshall dollars these tendencies can be expected to gather further momentum and strength. These therefore cannot be expected to act as a damper on the inflationary tendencies in India but would rather tend in the opposite direction.

That the present situation and the prospects held out by it are undesirable is accepted by all. A search for remedies must begin by a realisation of the elementary fact that no inflation has been known to have stopped by itself. A "suppressed" inflation by becoming open in the wake of decontrol does not spend itself and stop but starts a process which generates the next leap of the inflationary spiral. Deliberate and steadfast attempts have to be made for bringing under control an inflationary spiral already under way. Half-hearted measures only worsen the situation.

Tackling of inflation has two aspects: (i) the undoing of the inflation that has already developed and (ii) putting a stop to all further inflation. Both must be tackled simultaneously; one of them, by itself, is more than useless. In the Indian situation, as described and analysed in the foregoing sections, both these aspects can be tackled, firstly, by reversing the policy of decontrol and secondly, by balancing the budget. If only one of these is attempted, it will defeat itself. The institution of controls without a balancing of the budget, would make their successful working impossible because of the progressively increasing inflationary pressure on controlled prices of all commodities. A mere balancing of the budget, on the other hand, will for the time being stop

any further addition to the inflationary potential but will not reduce the pressure of the existing inflationary funds. In India the existing inflationary potential is enormous and by an increase in the rate of its turn-over it can carry the present price level several tiers up and maintain it there.

Both the revenue and the capital budgets of the Central Government must be balanced and if psssible the Government should budget for a surplus. The total outlays of Government must be met from current taxation and borrowing. The budget deficit can be reduced by increasing receipts and cutting down expenditure. In India the former can be done by (i) Increasing taxes especially income and business profits taxes. (ii) Reducing tax evasion (iii) Increasing Government borrowing—by schemes of compulsory savings, etc. Expenditure can be reduced by (i) Retrenchment (ii) Postponement of development schemes not likely to be immediately productive (iii) Reducing grants and loans to Provinces for development. (iv) Postponement of debt redemption and redemption, when inevitable, in new bonds only.

These measures should be supported by the introduction of an integrated and comprehensive system of economic controls. It must begin by imposing (1) a price stop (2) a profit stop and (3) an income (wages and salaries) stop. The subject has been exhaustively discussed by the C. P. B. Report on "*Controls and their Continuation.*"

If the Government really make up their mind and steadfastly pursue the objective of stabilization with all the means at their command, the present crisis can certainly be overcome. The price level can be brought down by gradual stages in a planned manner without giving rise to deflation. The contraction of money will automatically come about when inflation is checked effectively and a vigourous attempt made, by means of stringent overall controls, to integrate and bring down the price level by eliminating the present speculative bulges in it. This is the only way to avoid deflation. If, however, the Government, fighting shy of controls, tries to improve the situation by acting on the monetary side alone by such measures as the demonetisation of Rs. 100 notes, freezing of bank deposits, etc. they will only usher in deflation with all the attendant misery. And once deflation is under way, it is much more difficult to check than an inflation.

APPENDIX

NOTES ON EXCHANGE PARITIES

By Prof. D. R. GADGIL

Summary

1. The statistics relating to the index numbers of wholesale prices and the cost of living and to monetary circulation in India and countries with which India has important trading relations, show that at existing rates of exchange the external value of the rupee is much higher than its internal purchasing power.

2. This situation does not, however, appear to affect adversely the present capacity of Indian exports to find external markets. It does not also lead to a rush of imports such as would lower the level of internal prices or would embarrass the Indian producer.

3. The apparent contradiction can only be explained by reference to the prevalent general scarcity of goods, the existence of government controls, cartelisation of marketing and international undertakings regarding markets and prices.

4. No strong deflationary forces appear to be acting at present in India. On the contrary, a certain amount of inflationary pressure is evident. This may become more marked as controls are relaxed. This tendency together with the situation regarding foreign trade makes it undersirable that any attempt should be made immediately to equate the internal and external values of the rupee by lowering the external value.

5. The scarcity of supplies may last for some time. As soon as it vanishes the disparity in the internal and external values of the rupee, if it still exists, may bring about a sudden depression and may necessitate a measure of devaluation.

6. It is, therefore, essential that the necessary adjustment in the internal and external values is brought about during the period of transition.

7. The scarcity of supply of goods, as long as it lasts, will prevent the required adjustment. There are also other forces preventing an easy or automatic adjustment. These are, in the main, (i) protection granted to Indan industry and (ii) the high level at which the controlled prices of some agricultural and other products are maintained.

8. The prices of cereals, oilseeds and cloth, which are all controlled and which are all at a disproportionately high level hold the key position in the problem of adjustment.

9. They determine the cost of living index and through that index the cost of industrial labour in a very large measure. They influence the wages of agricultural labour, the cost-structure of agriculture in both commercial and subsistence farming.

10. The process of adjustment may not be difficult if initiated immediately and brought about in stages while there is yet a fair margin of profit between industrial costs and while taxation and indebtedness in agriculture have not been stabilised at levels corresponding to the present high levels of prices.

11. Lifting of all controls will only aggravate immediate inflationary pressure and increase the degree of maladjustment; in the absence of a gradual lowering of crucial prices during the transitional period the entire structure of costs may become rigid at a very high level.

12. The acceptance of present parities by Government, though, inevitable, involves the grave and urgent responsibility of deliberately planning and actively bringing about the adjustment between the internal and the external value of the rupee during the period of transition.

13. In the total plan for this action the central position is held by the prices of cereals, oilseeds and cloth. These must be adjusted under control and by degrees to the levels at which internal prices are expected to be in equilibrium.

14. Important minor aspects of the plan are (i) action to prevent, if possible, the supply position regarding imports being exploited solely for the profits of foreign producers and Indian intermediaries and (ii) action to protect the legitimate claims of Indian producers who started operations during war, avoiding at the same time unnecessary general taxation of the consumer and rigidifying a high cost structure.

15. The planned policy of Government and the targets set up by it must be announced and explained to the public at the same time as the decision regarding parities.

MEMORANDUM ON EXCHANGE PARITIES

A consideration of this question must begin with an examination of statistical data which may be supposed to indicate the present relative position of the values of different currencies. The data attempt a comparison of movements in different countries since the beginning of the war. The basic assumption in these comparisons is that the parities on the eve of the war were in equilibrium and the rates of exchange properly adjusted. A study of movements in the intervening period would then reveal the varying degrees of changes in valuations of currency since 1939. A large number of qualifications must be made before valid conclusions can be drawn from such data. It is unnecessary to enter into the theoretical discussion regarding this matter. Whatever the theoretical difficulties, it still remains true that these data provide the best available guide for a preliminary estimation of the existing position. The data available, for most countries, relate to increase in monetary circulation and to the wholesale and cost of living indexes of prices. For any one country the present position as compared with the pre-war situation must be viewed in relation to each other foreign country with which it trades. Under the new international regime the basis of parity for India will change from the basis of the sterling on which our exchanges have rested so long. In a multi-lateral economy the exchange rate will be established not through the sterling but directly for all currencies. Therefore, in determining the actual present parity or the most suitable rate for the future the comparative position in relation not only to the U. K. or to the sterling area but to all countries of the world must be taken into consideration.

It is of course, neither necessary nor possible to take account of conditions in every single country. We may confine our attention to those countries with which India had a large amount of export or import trade in 1945. These countries are the U. K., U.S.A., Canada, Australia, Ceylon, Egypt and Iran. Countries like Ceylon and Burma may be neglected because they are very much within the Indian sphere of influence and are chiefly acted upon by conditions in India. Enemy countries like Japan and Germany which took a large part in Indian foreign trade before the war no longer count for much. It is uncertain how early a recovery in their trade with India will take place. Also they share with the allied countries, like France and Belgium, the characteristic of having been largely affected by direct hostilities. Consequently, their economies and currency systems do not maintain the degree of continuity through the period which would make comparison of the 1939 data with the data relating to present conditions significant.

The data relating to price indexes may be first examined. In this as well as in respect of monetary circulation the six countries named above fall into two distinct groups. Four countries, U.K., U.S.A., Canada and Australia form one group and Egypt and Iran another. Both the indexes generally available, those of wholesale prices and of the cost of living, are affected by special factors of varying importance in each country, such as controls and subsidies. In most countries the index of the cost of living is much more affected by these disturbing factors than the index of wholesale prices. In India, however, the difference of the extent to which the two seem to be affected is small. In most countries the cost of living index number has risen much less than the wholesale index number; no similar disparity in movements is apparent in India. The Indian indexes of prices have moved upwards to levels much higher than the indexes of any of the four countries in the first group. The latest Monthly Bulletin of Statistics of the League of Nations gives, for February 1946, the following figures:—U.S.A. wholesale—141, and cost of living 130; Canada wholesale—144, and cost of living 119; U.K. wholesale—177 and cost of living 132; Australia wholesale—139, and cost of living 111; India wholesale—253, and cost of living (Bombay) 234. In Egypt and Iran, however, the movement is materially different from that in the four countries of the first group. For both these countries figures are available only for December 1945; they are: Egypt, wholesale—340, and cost of living 283; Iran, wholesale—549, cost of living, for September 1945, being 612. It is clear from these figures that the depreciation of value of currency has gone very much further in India than in the countries of the first group; in countries of the second group the movement is even more extreme than in India. Therefore, it would seem that at the 1939 rates Indian currency would be considerably over-valued in relation to the currencies of the first group of countries while in relation to the countries of the second group the position will be reversed.

Little further reference need be made to Egypt and Iran in what follows. The trade of India with Egypt and Iran is largely one-sided. From Iran, India obtains chiefly kerosene, petrol and similar products. From Egypt, the imports are chiefly of raw cotton. The exports of India to either of these two countries were comparatively small in 1945. The trade with these countries is thus not only one-sided but is concentrated in single products Further both these countries may seek and obtain changes in their rates of exchange during the process of stabilization. It is, therefore, important to consider the position of India in relation chiefly to U.K., U.S.A., Canada and Australia.

The figures for February 1946 given above indicate a situation still largely affected by control subsidies and other war measures. In recent months there has been a general movement towards the lifting of controls and the abolition of special war measures, with some resulting increases

in prices all round. The U.S.A. wholesale index moved up to 147 in June 1946 and the cost of living index stood at 133; in Great Britain the wholesale index moved to 179 in June 1946 and the cost of living to 133 in the same month. The Indian indexes, however, also showed an upward movement and stood at 264 and 278 respectively in June 1946. Additional increases have taken place since June 1946 and still further movements are predicted. These movements do not materially affect the relative statistical positions as revealed by the data for the first half of 1946. The release of control and the general pressure on supplies of especially primary commodities which are the factors bringing about this increase operate throughout the world and there is no reason to believe that a larger upward movement of prices will take place because of these factors in the other countries named above than in India. It might be argued that in so far as governmental action was more intelligent and effective in other countries than in India the result of the slackening of controls would be more in evidence in those countries. However, in no country is an abrupt change taking place from the regime of controls to no control and the lifting of controls or their slackening is made deliberately by stages. The countries which were able to control inflationary forces during the war are equally likely to check any tendency towards a runaway inflation afterwards. And the comparative differences in efficiency of planning or action between those countries and India does not seem likely to diminish in the immediate future.

An important consideration in judging of the likely pressure on prices is the extent of the difference in movements of monetary circulation. This is indicated by the following data of the index of notes in circulation, with June 1939 as its base. The index in March 1946 stood at: U. K. 266; United States 396; Australia 412; Canada 470; and India 660. The importance of the increase in notes in circulation is considerable for a country like India where credit money is not of the same importance as in the more advanced industrialised countries. The extent of the increase in the monetary circulation is indication of an inflationary potential which cannot be disregarded. It will be noticed that not only in U. K. but also in U. S. A. the increase in monetary circulation has been much smaller than in India. Further in countries where bank credit plays a large part credit controls can be much more effectively applied.

In India the full inflationary potential has not become operative only because of a number of factors keeping it in check. The concept of a difference in the velocity of circulation giving an effective circulation of money which is much lower than the potential is only useful as explaining why the price level did change only to a given extent and no more during a particular period. But such measurement of velocity is not reliable as a guide to the future. The velocities are functions of conditions of business and lowering of velocities during a period like

that of war cannot be taken to be a continuing feature. In fact there are a number of factors in the present situation in India which would indicate a tendency towards a possible increase in the velocity of circulation. These factors are the abolition of the excess profits tax and some reduction of Income-tax rates, the withdrawal of the Hoarding and Profiteering Ordinance and other similar measures of control, the more liberal capital issues policy, the higher denomination notes Demonetization Ordinance, etc. The large expansion of monetary circulation in India is therefore important for a proper appreciation of the present statical position. The disparity of the Indian movement in relation to that in other countries is even greater for monetary circulation than for the index numbers for prices; and if index numbers in other countries are supposed to be moving upwards under pressure of circumstances, the Indian index number is similarly situated but suffers in addition from the special pressure of a highly expanded monetary circulation.

The statistical data relating to indexes of prices and monetary circulation thus reveal a pronounced degree of overvaluation of the rupee at rates of exchange which ruled in 1939. If these rates of exchange are continued in the future the rupee is likely to have an external value far in excess of its internal purchasing power. On this evidence, obtaining a proper parity for the rupee must mean changing its rates of exchange so that its external value is brought down to a level better in relation to its present internal value. It might be noticed in this connection that the use of the term devaluation would not properly apply to this process. There is no consideration here of devaluating currency. Since 1939 the rupee has internally depreciated in value to a very large extent; the rates of exchange during the intervening period have been pegged and maintained rigidly. The movements in other countries have been dissimilar. The rates of exchange, therefore, no longer indicate the true relation between the value of the currencies of major countries with whom India trades. Therefore a change of parity would be necessary if it is desired immediately to bring the external and internal values of the rupee in proper relation with each other.

According to the provisions of the International Monetary Fund, it would not be sufficient for a country merely to state that the par value which it communicated as existing at a certain date did not indicate the exact or proper relation between the internal value of its currency; the country would have to notify that it considered that the par value existing at the particular time in the past was or is "unsatisfactory". At the time of the fixation of the initial rates the Fund and the country in question have to agree that a particular rate is "suitable". Under what circumstances is it likely that the Fund will be convinced that a particular par value is "unsatisfactory" and that a country is justified in making a demand for a change? Would a mere reference to the statistical position be deemed sufficient? Perhaps not; it would most

probably be necessary to prove that a rate was unsatisfactory in the sense of leading to some inconvenience in international economic relations or in the working of the internal economic system of the country in question. In this connection, it must be confessed that there are no signs that the existing situation relating to exchange rates is unsatisfactory. India closed the year 1945 with a favourable balance of trade in merchandise and during the months of 1946 for which data are available it would appear that there is no slackening in the pace of exports. There seems to be a continued pressure of demand in most established lines of export. Inspite of internal high prices and of a rate of exchange which externally overvalues the rupee the increase in exports is satisfactory. The present trading position does not seem to call for a reduction in the external value of the rupee. The pressure of imports on internal prices is also not very apparent. In few lines competition, which was entirely absent for a time have been revived but nowhere has it rached a stage where the Indian producer is seriously embarrassed. No case can thus be made out for saying that the rate of exchange has a depressing effect either on the export trade of India or on the working of its internal economic system. A study of the existing situation reveals two contradictory sets of considerations. On the one hand, there is a pronounced disparity, at existing rates of exchange, between the internal and the external value of the rupee; on the other hand, the trading position reveals no hardship having arisen on that account.

In the circumstances a detailed study of likely trends of events in the immediate future is called for. It may be made clear at the outset that the discussion is confined to a comparatively short period in the immediate future. This is a period roughly of from 3 years after the fixation of parity of exchanges and corresponds to the transition period of the Bretton Woods Agreement. It has often been said that any set of rates of exchanges would work equally well if there were no problems of adjustment in the transitional period and it has been estimated in the past that in a country which is industrialised and has a fairly large international trade the period of adjustment may be as short as two years. For us a period of from 3 to 5 years would seem to be necessary for bringing about the corrective adjustment in the economic system necessitated by a disparity between the internal and external valuation of the rupee.

The number of forces acting through this period may be differentiated according to as they make for an increased inflationary pressure on prices or act in the opposite direction. According to the general experience of most countries during the last 6 months the problems of reconversion have been less difficult to meet than had been previously feared. The deflationary effect of demobilization and the cessation of governmental war expenditure has not acted as a strong deflationary

force. The re-employment of demobilised personnel has not proved intractable and increased production for civil uses has proceeded at considerable pace in a number of countries. One of the most difficult problems of post-war years, that of British exports attaining a very much higher level than in pre-war times, seems to have been solved with comparative ease. Experience in India has been somewhat similar. Inspite of demobilization having proceeded far, shortage of labour persists in most directions. No definite unemployed fringe has yet appeared even in urban centres which experienced phenomenal expansion during war.

One special feature of recent Indian history invites comment. The increased monetary resources brought into being as a result of inflationary finance in India had not been widely diffused for most of the period of the war. Labour in some organised industries was the only class other than those of traders, speculators, industrialists and large farmers who had obtained a substantial increment in income. Even industrial labour, however, had not been able to attain till 1944 an increase which fully compensated it for the increase in the cost of living. This was in special contrast to conditions in England where it has been suggested that a part of the inflation since 1941 was itself due to abnormal increases in wages. (See article in *Lloyd Bank Review*, July 1946). During the last 18 months considerable additions had, however, been made to the money incomes of the previously disadvantaged classes. Agricultural labour has at last, rapidly improved its position and in some areas the increase in its wages fully covers the increase in the cost of living ; this is specially so in areas where lucrative commercial crops like sugarcane are grown. Industrial labour, skilled and unskilled, has continued to gain ; and as in other countries the period after the cessation of hostilities has been marked by a number of strikes, of which a fairly large number have been successful. Apart from labour the lower classes of salaried employees, who are liable to suffer most during times of rising prices, have also received considerable additions to their money incomes in the shape of either dearness allowances or a readjustment of salary scales. Large classes of workers such as Railway or Postal employees, Police constable, primary teachers, clerks in a variety of employments and grades have, specially in recent months, been able to obtain, some late and partial relief. The movement seems to have gained momentum and to be proceeding apace. Salary revisions are forecast on a fairly wide scale for all types of government employees and the salariat in private employ will in due course also profit from the movement. In view of these facts it is no longer true to say that increased money incomes are concentrated in the lands of very small numbers and that the diffusion of monetary resources is such that the higher price levels could not be sustained once supplies in normal quantities are forthcoming on the market.

Government expenditure is another factor which would affect the price situation. There has been in recent months a cessation of expenditure and purchase activities on account of His Majesty's Government and other foreign governments. There is a certain amount of contraction also brought about in the expenditure of the Central Government on military and defence accounts. The pressure of financing central deficits and the purchases of other governments no longer exists. This might be taken to be a factor making for deflation. As against it must be set the increased programmes of expenditure undertaken, partly in the hope of Central subventions on post-war reconstruction by provincial governments. The extent to which these expenditures will materialise is difficult to estimate. The expectation of their being made, however, is an important factor in the situation. On the whole it might be said that increased provincial activities would partly offset the diminution in the activities of the Central Government and that the deflationary effects of the latter taken together with the fact of demobilization would affect only a few centres or regions in the country.

Another factor damping down the price level might be increased industrial production. An increase in the physical volume of output has been a notable feature of war years in a number of important belligerent countries. After years of greatest war activity some fall in production was experienced in these countries; this was marked specially during 1945. After the initial difficulties of reconversion had been met the volume of production again began to take an upward turn early in 1946 and it stands today in a large number of countries, not directly affected by warlike operations, well above the pre-war average. (For comparative data see 16th Annual Report of the Bank of the International Settlements). The situation in India is somewhat obscure. Employment in a certain number of perennial and seasonal industries had increased largely through war years. It is also reported that a certain degree of increase in agricultural production took place during the same years. There has, of course, been a certain amount of increase in supplies of materials specially required during war and in the activities of government-owned factories. On the whole, however, there has been no increase in the physical volume of production in India comparable to to that in U. K., U. S. A., or Canada and Australia. The proportionate increase in agricultural production has not been great. Indeed there is some doubt whether any actual overall increase of productive capacity of a type that can be maintained continuously has taken place in agriculture in India during war years. There is, on the contrary, a danger that the capacity of the soil and of such resources as forests, etc., has in some tracts been significantly impaired. In respect of industrial production the bottleneck in India is capital equipment and to some extent technical labour. The increase in war production was, in India, perhaps to a larger extent on direct governmental account than else-

where. There has been no immediate reconversion of this production potential on a cessation of the activities of the governmental factories. In industries like cloth the problem of reconversion or of the use of capacity released from defence needs will not cause much trouble. In industries which rose up specially during war and had been linked to war-like production the problem of reconversion may prove much more difficult and, at least immediately, production may fall.

From the point of view of the internal situation inflationary pressure could be eased if there was increase in supplies internally from either (a) increased internal production (b) release from use connected with war and (c) reduction of exports. The chances of increased internal production during the short period of transition do not seem to be large. They are very slight for agriculture and will depend for industrial production on the volume of the imports of capital equipment being large enough to add substantially to our production after making up for the depreciation of the position during war. In respect of release of supplies from use for defence purposes it is difficult to make any estimate. It is likely that for some products and in particular centres or regions this may prove a substantial factor; but its significance for the country as a whole is not likely to be large. Reduction of exports, on the other hand is not likely to give any relief. In most directions Indian exports during war had sunk to levels considerably lower than those before the war. The demand from abroad for most types of exports is brisk and it would not be to the advantage of the country to cut off relations with the importing countries for an extended period. While, therefore, the volume of exports in many directions may have to be stabililised this cannot be done at a level much below the level of war years. Indeed, in some cases as that of cotton it might be thought advisable to attain a level of exports which is substantially higher. It would thus appear that while forces making for a depression of the price level such as decreased expenditure on government account or increase in available supplies may have an effect which is neither certain nor large, the recent diffusion of increases in money incomes and the physical demand resulting from the cumulation of unsatisfied demand during war for both capital and consumer goods are likely to keep up a strong upward pressure on prices.

It will be observed that no account has been taken so far of the effects of the impact of the external situation. The manner of impact will itself depend largely on the par value of the rupee and cannot therefore be considered as apart from that par value. We now proceed to consider what is likely to happen if the present rates of exchange are maintained in the immediate future. It has been shown above that at present there is a disparity between the internal and external value of the rupee. There is no way of exactly measuring this disparity but statistical data presented above indicate that it is large. Further, while

it is true that prices in other countries are subject to inflationary pressure there is nothing to show that the inflationary pressure on prices in India will in the near future be any less. Therefore the disparity in the external and internal values of the rupee is not likely to be less than that suggested by the statistics for the first half of 1946 if the present rates are stabilised by the Fund within the next few months.

Ordinarily imports should be stimulated and exports discouraged by an external over-valuation of a currency. A reduction in the internal price level should follow. The consumer should obtain his supplies cheaper than before and the producer be affected by the fall in prices and also in special lines by increased competition of imports. To what extent, if any, are all these effects likely to take place during the few years immediately following the fixation of parities? The major factors governing the whole situation seems to be the great shortage of all kinds of supplies. The shortage seems to be universal, affecting agricultural produce, other primary commodities as well as manufactured goods. This shortage seems likely to obscure for some time the effects of the disparity in the internal and external value of the rupee. Today even with a high level of Indian prices and at the current rate of exchange Indian commodities like jute manufactures, tea, shellac, copra, hides and skins are in active demand. The rate of exchange does not seem to act as a damper on exports. To that extent the Indian price level itself may be taken as affecting price levels in other countries and pushing them upwards. The total effect of this force will of course not be large especially as the Indian commodities are mostly raw or subsidiary materials.

The same scarcity of supplies which makes for the overvaluation not affecting the volume of Indian exports also leads to no extra or specially large flow of imports. The goods from other countries desired by Indians, both capital and consumer goods, are available today in strictly limited quantities. There is a large gap between the Indian price and the price at which the importer can afford to sell. But the gap does not result in a rush of supplies which will so satisfy the market as to lead to a closing of the gap. The resultant situation has many peculiar features. The most dominant fact, however, is that imports do not as they should exercise a downward pressure on the internal price level or cause serious embarrassment to the Indian producer in general. It might be argued that this is a purely temporary phenomenon, that in due course the effects of the overvaluation of the rupee will make their appearance. It is difficult to believe that this will really happen in the immediate future. In order to understand this a somewhat detailed examination of the situation relating to prices, production and trade is necessary.

Such an examination must start from the data regarding the movements of prices of various groups of commodities. The following table

sets out the latest available details of the index numbers of the groups of commodities making up the Economic Adviser's Wholesale index numbers.

TABLE

Lac	1179
Copra	921
Tobacco	—
Wheat	373
Linseed	352
Leather	352
Groundnuts	340
Rice	322
Coffee	306
Wool Raw	300
Coal	294
Cotton manufactures	261
Jute manufactures	256
Galvanised corrugated sheets	229
Jute Raw	227
Hides and Skins, Raw	200
Cotton Raw	188
Cement	182
Sugar	169
Tea	164
Kerosene	151
Petrol	139
Pig Iron	117

The possible movements in the immediate future of these components of the wholesale prices index may be indicated. Products of Indian industry and the group of manufactures may be first considered. It is apparent that the price level in this group as a whole has moved up less than the average and much less than the price levels of agricultural products. Among the products of Indian industry the largest increases in prices are registered by coal, cotton manufactures and jute manufactures. The market for coal in India is an entirely internal market and Indian coal has never been subject to much competition from imports. Where the world as a whole faces a shortage of coal for some time it is unlikely that the internal price of coal will be materially affected by the price of coal abroad. Jute and jute manufactures are so much an Indian monopoly that world prices for them are determined chiefly by the volume of world trade as a whole. The various efforts made during war have been unable to establish a substitute for jute. The cotton mill industry in India is also in a special position. As long as there is no revival in the production of cotton manufactures in Japan or increase in China the Indian producer is in a strong position in relation to the markets of the East. His hold on the large internal market is also firm. The competition from imports, if any, will be small and

indirect. On the other hand, during war the industrialist has placed himself in a position where he virtually controls the prices of his own products through the government machinery for the fixation of prices. Movements in the price of cotton in India will thus be determined in the immediate future not by rates of exchange or competition of imports but by direct action of Government which is, at least today, largely influenced by the industrialists. Among other important Indian industries those likely to be affected by imports are iron and steel, sugar, cement and paper. The price of pig iron has moved the least upwards. The manufactured product of the iron and steel industry included in the index is galvanized corrugated sheets. The index for these has reached a high figure at which the competitive strength of imports might be very considerable. Two facts are noticeable about this particular situation. In the first instance at present levels of production it may yet take some time before the world demand, including the demand from the capital goods industries and the building trades, is fully met. Secondly the Indian industry has been built up almost entirely by protective tariffs through past decades. It is, therefore, highly unlikely that the industry will be allowed to feel the full effects of the competition of imports when this begins. The sugar industry, though not a key industry to the same extent as iron and steel, is in many other respects similarly situated. It is a protected industry and the price of sugarcane is of great significance to large number of agriculturists in many important regions of India. Also sugar prices have on an average moved up much less than the prices of other commodities. It is not necessary to go into detail into the probable fortunes of other industries. It may, however, be said that to the extent that they have been established under protection their claims are likely to receive sympathetic consideration from the state. As long as keen competition in the international market is absent no price-cutting in the Indian market need take place and Indian industrialists who have for the most part to seek no export markets will find a fair profit in the internal market.

In connection with the pricing of imported goods in general, emphasis must be laid on the formation of syndicates of producers, of cartelisation in marketing and on international understandings among manufactures regarding prices and markets. All these tendencies which were apparent before the war have been considerably strengthened through war controls and through bulk purchases and government trading. The imported manufactures are thus likely to move in not at the fair price at which exchange rates allow sales to be made, but at the highest price which the exchange and the Indian market situation together allows importers to charge. All the restrictive features of war time are continued and systematised by the post-war scarcity situation. Therefore, unless supplies are very much larger in volume than the extent they seem likely to reach during the next two or three years, the

rate of exchange and the special advantage it gives to importers are not likely to redound to the advantage of the Indian consumer by any special abundance of imported supplies or by specially low prices for them. *Pari passu* they are not likely to put any pressure on the prices and activities of the Indian producer. This applies as much to a large industry like cotton manufactures as to a small one like paper.

It is next important to see how increased imports are likely to affect the prices of agricultural products. The agricultural products whose prices have risen the most comprise two main groups, cereals and oil seeds. The prices of cotton and jute have not increased to an extent comparable with the above group of commodities. Hides and skins and tea, have increased less than the average of Indian prices. For the most part the imports of agricultural commodities do not come from countries which have successfully controlled inflation. Cotton imported into India comes chiefly from Egypt and East Africa. The inflationary movement in Egypt has proceeded further than in India. There is no immediate glut of cotton production even in the U. S. A. and Indian cotton prices have kept below the average of wholesale prices. There is little likelihood of imports at present parities leading to a further fall in the cotton price level. During the war prices of tea were well under control. The rise in them has been marked only during the last year. This might reflect a strong general consumers demand. Large competitive supplies of tea are not likely to emerge in the next few years. The price level of Indian tea, therefore, may not suffer a fall because of the present parity except as a part of some general movement.

The prices of cereals and the oil seeds group present a problem which is full of difficulties. The supplies of oil seeds, in the international market come mostly from countries the monetary and economic conditions in which have not been highly controlled or stabilised. The position of rice supplies is very similar. It is only in the case of wheat that supplies on the international market as also imports into India originate largely from countries in relation to whose currencies the Indian rupee is definitely overvalued. The world production of food-grains and oil seeds is not likely to approach a level well above current demand within an year or two. The situation of scarcity may thus persist and agricultural prices may not show a downturn in a general way. This would really mean that as between agricultural products and manufactured goods the terms of trade would move in favour of the former so that agricultural prices might be stabilised, at a level higher than the average movement and distinctly higher than the index for manufactured goods as compared with 1939. The phenomenon of farm products as a whole moving higher than prices of manufactured goods during recent years is observed also in countries like U. S. A., U. K., and Canada. The decade after the war of 1914–18 witnessed a general movement of the terms of trade in favour of industrial counties. At the end of this

war a similar break in agricultural prices is not apprehended. It has been shown that the demand even for cereals is now more elastic and therefore increases in production can be sustained without breaking prices. (See Report of the Bank of International Settlements, 1946). Granted this, does it mean a general long run movement in favour of countries exporting agricultural produce and can such a movement, resulting in proportionately higher prices in agricultural sector, be maintained over a long run of years? These are difficult questions but it is not necessary for us to look very far. The immediate pressure on agricultural products is obvious and its continuance for a year or two does not seem to be in doubt. During this period prices in the agricultural sector may be able to maintain themselves at a disproportionately higher level; but this does not answer the question whether the present Indian prices can be maintained under pressure of imports. This will depend partially on the general problem of the demand for agricultural products and partially on the parities fixed for the African and Asiatic countries from whose products the exports from India meet competition in the international markets. The internal situation has to be studied at the same time.

In cereals there is a group, millets, which meets no competition from foreign products either on the international or the domestic markets. In rice and wheat Indian produce are not in need of export markets but imported rice and wheat might influence the internal price level. Today the situation is absolutely controlled by the practice of government purchase. For some years past supplies of rice and wheat have passed more and more into government control and imports are all on government account. The prices obtained by the agriculturists in most provinces are prices fixed by governments and remaining fixed usually for a year at a time. Thus whatever the disparity between the rise of prices in importing countries and in India the impact of the price level of imported wheat or rice will be apparent only when proper action is taken by government. The disparity in movements is undoubtedly very considerable. For example, the average prices of wheat per bushel received by farmers in Ontario varied between 66 and 76 cents from 1938 to 1940. In 1946 the price has so far been only a few points above 110 cents. The average increase in price has been of the order of 60 per cent. On the other hand, the index number of Indian wheat prices stood in June 1946 at well above 350 as compared with prices in 1939. The resulting situation holds a number of different possibilities. Under conditions of a free market and ample imports, wheat from Canada, Australia or the U. S. A. should pour in large quantities and lead to a precipitate fall in the prices obtained by the Indian grower. If internal prices are all governed by government and government controls imports, government may bring imported supplies at favourable rates and may sell them at a profit or may average the prices of imported and domestic;

supplies not making any profit for itself. On the other hand, it is likely that a level of internal prices much higher than prices at which imports are available will only lead to foreign producers asking for a price which is the same as the price paid to the domestic producer even though the price of imports is much lower. This will happen when the Government is specially in need of these imports.

The maintenance of the immediate domestic price itself will be a matter entirely of Government policy. As long as trade controls continue prices will have to be fixed by Government and in doing this the prices of imports will be only one consideration. If, however, Government control is not considered permanent then the influence of the price of imports on prices fixed by government will depend on the period for which government control is to continue. For, government policy must take into account the fact that unless at the time of the lifting of controls imported and domestic prices of grains are in some relation of parity the impact of free imports on the removal of control may be disastrous to the domestic producer. Government price policy can thus not be entirely oblivious to movements in prices of imports. In so far as the present par value of the rupee determines the level of these prices, the price level of imported wheat at these parities indicates the target which governmental policy must attain at the end of the period of transition, say in 3 years. This gives almost a quantitative measure of the stages in which and the degree to which a lowering of the price of wheat must be definitely brought about.

The marketing of oil seeds is not as completely controlled by Government as that of cereals. However, the price levels of various oilseeds are almost completely determined by Government action. A recent conference held by the Central Government recorded its opinion that Government control over the prices and distribution of oilseeds should be continued for some time. The present severe pressure on supplies and the need to allocate them between competing demands makes it probable that the control will not be lifted for two or three more years. In relation to the prices of the oilseeds group, as a whole, as also of rice, the position is somewhat confused. The level of the prices of wheat and the par values in countries such as U. S. A., U. K., and Australia are comparatively fixed and predictable. This is not the case with rice and oilseeds prices. They are produced in countries whose economies and currencies have been either greatly disturbed or are in a state of flux. The price of these in the future when imported into India or meeting Indian products in international markets depends not only on the ease with which the internal conditions are settled but also on the ultimate par value fixed for their currencies. If, for example, the par value of Egyptian currency is unchanged Egyptian cotton prices may remain distinctly high; on the other hand, because of the large measure of inflation in that country the currency might be devalued as

compared with the value in 1939. The comparative prices will depend on the measure of this devaluation. In case India retains its older par value and other countries suffering from severe inflation devalue their currencies, as is likely they will do, then the prices of their imports into India are likely to stand in the same relation to Indian prices as the prices of Canadian or Australian wheat to the prices of Indian wheat.

There is still another set of important imports into India. These are imports like timber, oils, metals and ores, manures,etc. which are not likely to affect adversely Indian production activity; on the contrary, at favourable prices they are likely to stimulate such activity. Favourable prices for imports of capital equipment which is likely to take place on large scale in the near future will also be on the whole beneficial to Indian economy. The only question likely to arise in the matter is the interest of some type of manufacturers who have begun to produce specialised products on a small scale during the period of war.

To sum up this part of the discussion: (1) the external value of the rupee stands high in relation to its internal value in terms of currencies of countries which have not experienced an abnormal expansion of monetary circulation and which controlled inflation successfully during times of war. (2) The trend of events shows that imports during the next year or two will most probably not bring down materially the present price level of manufactured goods in India owing to (a) comparative paucity of supplies and (b) the cartelization of marketing of produce and international understandings regarding prices. The Indian consumer is thus not likely to benefit from what appears to be a parity favourable for imports. (3) The main Indian manufactures are also not likely to be affected by imports because of the reasons adduced above, added to which is the fact of the continuation of tariffs and a policy of protecting industries in general. (4) The present par value is not likely to result immediately in a deflationary pressure on prices of agricultural commodities, which are Indian specialities In the group of cereals and oil seeds the prospect beyond a year or two is uncertain depending on the stabilization of economic conditions and on the par values determined for countries in Africa and South East Asia, on the government policy of control of prices and the objectives set up by this policy.

If the above evaluation of trends is accepted as probable the contradictions in the present situation are further emphasized. Granted an initial disparity in the internal and external value of the rupee the course of events during the next year or two does not appear likely to bring about either rapid or gradual adjustment which would eliminate it. The natural course of events might continue the disparity or even intensify it and thus make for a persistence of a grave potential danger. In the circumstances acceptance of the present par values by Government imposes on it the grave and urgent responsibility of bringing about the necessary adjustments by planned and deliberate policy. This

problem may be best considered in relation to price controls actually exercised by Government to-day. With cereals may be associated the group of pulses which is not represented in the Economic Adviser's index. The Calcutta index shows that the rise of prices in the pulse group during the last year has been even larger than in the group of cereals. The prices of pulses depend partly on the prices of cereals and partly on the internal pressure on supplies of food. In every way this central group of the prices of cereals and pulses and oil seeds plays a dominant part in Indian economy. An adjustment of the price level as a whole at any particular point will depend on the appropriate adjustment of prices in this group. These prices constitute together with the price of cloth, the major influence on the cost of living index, urban and rural, and it is these that are responsible for the present increase in the cost of living index. Cereals and pulses and vegetable oil and cloth are not only the most important items but they are also the items in which the price index shows the largest upward movements. For example, other items in the Economic Adviser's index which influence the movement of the cost of living index such as sugar, tea, and kerosene are greatly below the index for cotton manufactures which is itself well below the cereals and the oil seeds group.

The cost of living index is of vital importance in the adjustments that have to take place for any movements towards parity of the external and the internal value of the rupee. The level of industrial costs in India today seems to leave a very considerable margin of profits to the industrialists, as a whole. The prices of raw materials of most Indian industries, other than those in the oil seeds group, have increased much less than the prices of manufactured goods. Most imported materials also are available or should be available at costs less high in proportion than those of the products of Indian industry. The movements of wages have not been uniform over the country. In the major organised industries there has been a tendency for wages to follow the trend of the cost of living index and for a large part of the total payments to labourers to consist of a dearness allowance. It may be assumed that some adjustment in the rate of payments of dearness allowances, where they are specially high, would be possible following a significant reduction in the cost of living index. In this event the adjustment of industrial costs, wherever this is necessary, to a lowering of the general price level would depend on the cost of living index itself.

The most important of such cases is the price level of cotton manufactures. The level of profits earned by cotton mills during war time indicates the existence of a distinct margin between costs and prices. A movement of cost of living downwards would further help in the lowering of the labour cost in the cotton industry wherever it has risen specially high. The price of cloth is itself an important factor in

the cost of living. All this points to a necessity of lowering the controlled price of cloth by degrees to as low a level as possible.

The cost of living index plays an important part in the structure of agricultural costs also. The wages of agricultural labour have risen rapidly only during the last year or two. These wages, on account of a complete lack of organisation, are not as rigid as the wages of industrial labour. Either a redundancy of labour or a definite lowering of the cost of living index would easily make for a lowering of the money wages of agricultural labour. Among the costs of farming of commercial produce today the wages of labour form an important item. The cost of living is also important from the point of view of the subsistence farmer who does not employ labour to any considerable extent. Without a lowering of the price of foodgrains, oil seeds and cloth no general adjustment of the price structure downwards would be possible in the rural economy.

In the problem of the adjustment of agricultural prices one important aspect of the present situation needs to be emphasised. During the depression of the thirties the rigidity of certain monetary costs was found to affect the agriculturists adversely to a very large extent. These were the land revenue and other tax payments and the charges on account of indebtedness. At present the real burden of both these categories of payments has been largely reduced. Taxation which falls directly on the agriculturists has not moved up to any appreciable extent. The private agricultural indebtedness has been considerably lowered in some regions and for some classes. In others it does not stand much below the 1939 level but has not yet mounted appreciably above it. Once, however, the margin between agricultural costs and prices has been lowered the new debts contracted by the agriculturists will correspond to the new level of prices. Until this happens the level of indebtedness which might on an average be today a little below or a little above the 1939 level is in real terms much lower than the pre-war level. As long as the indebtedness of the agriculturists is not adjusted upwards to the new level of prices a movement towards the lowering of the price level will not be difficult to initiate or to carry out. Any postponement of such a movement is, however, fraught with great danger. The agriculturists will, in due course, increase their debts for either buying land or for capital improvements in agriculture or for working capital or for domestic expenditure. The size of all these new debts will be determined by the existing high price level. Once this movement has gone on for some time the structure of agricultural costs is bound to become highly rigid and would have to be stabilized at somewhere near the existing level. It might equally be expected that the level of taxation of Provincial Governments will begin to mount up as salary and other expenditure is slowly adjusted to the post-war level. It is only as long as the monetary burden of debt and taxation still

remains at the present level that an adjustment of agricultural prices could be carried out without undue suffering to the agriculturists.

The present situation is thus very complicated. The internal and the external prices of the rupee are obviously out of parity to an alarming extent. The immediate situation is, however, not alarming because there is yet a brisk demand for such quantities of Indian exports as can be placed on the international market. And the scarcity of supplies results in the prices of imports neither exerting a pressure on the internal price level nor affording a relief to the Indian consumer. A policy of abolishing controls is likely, in the circumstances, to have initially the effect of further putting up the prices of consumers goods in the country. This was exemplified by the quick reaction to the extraordinary action of the Government of Bombay in lifting all control over *gur*. Such unthinking abolition of control will most probably lead to increasing the disparity between the internal and external price levels still further. The situation will continue to hold this danger until the present pressure on supplies of all kinds is eased. Before this happens the position will be still further out of adjustment than it is today, if government policy is either not well planned or is enforced with laxity. The experience after the last war shows that the stage at which the relation between demand and supply is reversed may be reached abruptly and the effects on price levels after the reaching of such a point are precipitate. In the meanwhile, in the absence of control, both industrial and agricultural costs would have been made rigid at highly inflated price levels, that is, in relation to the internal value of the rupee. For example, if the pressure on supplies takes about 3 years to be eased the position at the end of 3 years would most probably be that the prices of agricultural commodities and Indian manufactures stand, on an average, even higher than the present levels, that the cost of living index also keeps high and the whole cost structure is rigidified round this. With exchanges fixed at present parities by the International Fund and the economics of other countries well under control there is no reason why the disparity between the internal value of the rupee should be any lower than at present. The shock to our economy at that stage will be severe and it will be in no position to bear it.

It is thus clear on the one hand that an immediate attempt to bring the external value of the rupee into parity with its internal value is not advisable. Such a step is not likely to be accepted by the Fund, it is not likely to help our export industries and moreover, it is likely to intensify an inflationary pressure which is still operative to a large extent within the country. While this is true, it would be equally disastrous to believe that any adjustment between internal and external values will automatically come about in due course. Not only is this unlikely to happen in an uncontrolled Indian economy, but also lack of controls and deliberate planning is likely to intensify and rigidify the present

position of mal-adjustment. Pressure of circumstances leads to the effects of mal-adjustment not being immediately operative in the Indian economy. As soon as these circumstances vanish the full results of the mal-adjustments will be apparent and it will be difficult at that time to deal with the situation. A depression and at least a partial devaluation will then be inevitable. This could be avoided only if the Central Government in India plans an intelligent policy for the period of transition and successfully carries it out through that period.

The major problem for this period is the lowering by degrees of the price levels of foodgrains, oil seeds and cloth. Government control of all these is postulated throughout the period of transition and is necessary even apart from the problem of price parities. An immediate announcement of the target and a general indication of the steps by which they would be reached is necessary. In this context it might perhaps be difficult to determine immediately the exact target, but a broad indication of it is both possible and necessary. The level generally suggested for ultimate stabilization of both the internal and external price levels is roughly double that of the pre-war *i. e.*, 1939 level. Even if it is presumed that the prices of agricultural products might be maintained at a level somewhat higher in relation to the pre-war level than the price level of manufactured goods the average for agricultural products as a whole could not be much higher than double the pre-war level. For special reasons it is impossible to contemplate a more than average stabilised level for cereals and oil seeds. Therefore, it would be necessary to visualise the bringing down of the prices of cereals and oil seeds by about a third of their present price level and the price of cloth by at least a quarter of its present price level. When such policies are definitely determined and announced in advance the trend of adjustments will automatically set in that direction. It might also be then possible to guarantee definitely that no precipitate fall which brings the price level below these targets would also be allowed by Government during or even after the transitional period. The total range is not too large to be achieved over a 3 year period and if the programme is known beforehand no rigidifying of the cost structure would take place. This is the central and the most important of the problems of adjustment.

There are two other problems which relate to the transition period to which also due attention must be paid. It has been emphasized above that short supplies and cartelization would lead to the disparity between the internal and external price of the rupee being exploited solely to the advantage of the foreign producer and the Indian intermediaries. Government action should as far as possible be directed towards preventing this from happening. The appropriate action for the different types of commodities would be different. Purchases on government account, control of prices, control of distribution, etc. have to be tried. It may

even be necessary for specific items to seek to enter into trade agreements with other countries.

Another problem of transition would be concerned with the fate of the smaller industries which have arisen during the war. It has been pointed out that the major Indian industries like cotten, jute, sugar and cement may not be immediately affected by competition of imports and the general structure of protective tariffs will be found adequate to deal with their problems. The problems of the large number of miscellaneous industries which are chiefly the product of war time may, however, neither adequately nor appropriately be solved by means of merely protective tariffs. General protective tariffs are also liable to lay too heavy a burden on the consumer in relation to the field or range of industry protected. It would be necessary to deal in a special manner, such as by detailed and specific regulation of only certain types of imports, with these problems. The various devices allowed to countries during the transitional period by the International Monetary Fund may be utilised for this purpose. It is obviously necessary that these devices be used with great discrimination lest new vested interests are unnecessarily created and the consumer needlessly taxed.

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